



# OFFICE OF AUDITOR OF STATE STATE OF IOWA

State Capitol Building  
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

David A. Vaudt, CPA  
Auditor of State

## NEWS RELEASE

Contact: David A. Vaudt  
515/281-5835  
or Tami Kusian  
515/281-5834

FOR RELEASE

April 16, 2012

Auditor of State David A. Vaudt today released a report on the Iowa Lottery Authority (Iowa Lottery) for the period July 1, 2002 through June 30, 2010. The review was conducted to determine the impact of the Iowa Lottery becoming an Authority.

From 1985 to 2003, the Iowa Lottery operated as a State agency and was subject to rules and regulations consistent with all other state agencies. However, effective September 1, 2003, the Legislature established the Iowa Lottery Authority. As an Authority, the Iowa Lottery is not subject to general state government oversight applicable to state agencies.

Vaudt reported annual revenues have increased since fiscal year 2004, when the Iowa Lottery became an Authority. However, Vaudt concluded the increased revenues realized by the Iowa Lottery were not a result of the Iowa Lottery becoming an Authority. All the activities which resulted in increased revenues could have been conducted by the Iowa Lottery as a state agency. Although certain revenue-generating activities may have been implemented more quickly due to the Iowa Lottery's status as an Authority, each of the activities resulting in significant revenues was permissible for the Iowa Lottery to conduct as a state agency. In addition, other state lotteries which operated as state agencies for the same time period realized similar revenue increases.

Vaudt reported the Iowa Lottery's status as an Authority has also allowed the Iowa Lottery to make significant changes to its compensation practices for certain employees. In accordance with the *Code of Iowa*, the Iowa Lottery's Chief Executive Officer (CEO), with approval from the Iowa Lottery Board, has power to designate particular employees as "key personnel." Of the key personnel, the CEO is appointed by the Governor and compensation and employment terms for the CEO are set by the Governor. Other key personnel are exempt from the State's classification and pay plans and their salaries are set by the Iowa Lottery.

Vaudt reported:

- As a result of the Iowa Lottery becoming an Authority, the Legislature no longer establishes a salary range for the Iowa Lottery CEO, as it does for other Department Directors. During the 6 years from fiscal year 2005 through fiscal year 2010, Governor Vilsack and Governor Culver authorized annual salary increases for the prior and current Iowa Lottery CEOs which totaled \$358,856.43 more than would have been possible if the Legislative salary range for the Iowa Lottery CEO had been maintained. The Iowa Lottery has increased the

salaries of other key personnel to amounts significantly higher than the maximum salary amounts they would have been eligible to receive if the Iowa Lottery had remained a state agency. Vaudt reported the increased annual authorized salaries of the other 8 key personnel totaled \$589,429.23 more than would have been possible if the State's salary ranges for the 8 positions had been maintained during the 6 years from fiscal year 2005 through fiscal year 2010.

- The Iowa Lottery hired a consulting firm to conduct a compensation review in 2004 after the Iowa Lottery became an Authority. However, Vaudt determined the compensation review was conducted in a manner which virtually guaranteed Iowa Lottery salaries would appear low. The compensation review primarily utilized private sector and nonprofit entities as the basis of its market salary comparison for each key position included in the review. In addition, the review was limited to salary data from only 7 state lotteries. According to an article published in 2009, all 7 CEO's of each of the state lotteries utilized for the compensation review were among the highest paid state lottery CEO's in the country. According to the consultant, when the compensation review began in 2004, the prior Iowa Lottery CEO directed the consultant to limit the comparison with other lotteries to the 7 state lotteries with entrepreneurial structures and to exclude all the other state lotteries from the review.

After receiving the results of the compensation review, the Iowa Lottery approved increasing a majority of the key personnel salaries to the maximum salary amount recommended in the compensation review over a 2-year period. However, according to the consultant, she recommended a large salary range to allow for gradual salary growth over time. The consultant stated she did not recommend increasing key personnel salaries to the maximum salary included in the compensation review and it was not a practice she would have supported had she been aware of how the Iowa Lottery would implement the results of the review. After completion of the compensation review, all Iowa Lottery key personnel received significant salary increases.

- Governor Vilsack and Governor Culver approved incremental salary increases for the prior Iowa Lottery CEO from \$122,811.38 in fiscal year 2003 to \$239,777.46 (a 95% increase) in fiscal year 2008, when he retired. In addition, when the prior Iowa Lottery CEO retired, he began receiving significantly higher IPERS benefits for the duration of his life because of the salary increases he received when the Iowa Lottery became an Authority. According to IPERS, the prior Iowa Lottery CEO's IPERS benefits are nearly 60% higher than the IPERS benefits he would have received had the Iowa Lottery remained a state agency.
- From fiscal year 2005 to fiscal year 2010, the total salaries approved for the Iowa Lottery CEO and key personnel in excess of the State's pay plan totaled \$948,285.66. The additional IPERS and payroll contributions associated with those approved salaries total \$87,175.32. Accordingly, since becoming an Authority, the authorized salaries in excess of

the maximum allowable under the State's pay plan for the Iowa Lottery CEO and key personnel plus the related payroll contributions is over \$1 million.

- The Iowa Lottery Board inappropriately delegated the compensation review to Lottery officials who would be financially impacted by the results of the review. The delegation created several issues with critical parameters of the compensation review, which caused flawed compensation review results and inadequately justified key personnel salaries. It appears the Iowa Lottery Board failed to properly exercise its fiduciary responsibilities in determining and approving appropriate key personnel salaries.
- Iowa Lottery key personnel received significantly larger salary increases and larger overall salaries than their counterparts in other State entities. By comparing the Iowa Lottery CEO's base salary to comparable positions at other larger State entities, it is readily apparent the Iowa Lottery outpaced other State entities in regard to CEO pay increases and total base pay. Other Iowa Lottery key personnel also received higher salaries than their counterparts at larger State entities.

In addition, a majority of State Department Directors included in the review did not receive any salary increases in fiscal years 2004 and 2005 while Iowa Lottery salaries increased substantially. A majority of the State Division Directors included in the review recognized salary increases ranging from 6.12% to 13.38%. During this two-year period, the prior Iowa Lottery CEO's salary increased 68.55% and other key personnel received salary increases ranging from 13.86% to 27.55%.

- Some Iowa Lottery personnel receive more compensation than allowed for their counterparts in State entities even though the Iowa Lottery has continued to operate in essentially the same manner as was done prior to becoming an Authority. Making the Iowa Lottery an Authority has given the Iowa Lottery CEO and Board the flexibility to reward employees beyond restrictions placed on other State entities. As a result, there is an appearance Iowa Lottery officials are more valuable than other State employees.

Vaudt also reported a published article showed the current Iowa Lottery CEO's salary for 2009 to be the 9<sup>th</sup> highest of 44 Lotteries reviewed. The 2008 salary of the prior Iowa Lottery CEO would have been 5<sup>th</sup> highest of those 44 Lotteries.

While the Iowa Lottery CEO's salary is one of the highest in the country, the amount of funds transferred to the State's General Fund as a percentage of ticket sales is one of the lowest. According to certain U.S. Census data for fiscal year 2007, the Iowa Lottery's sales per capita were 58.5% lower than the national average and administrative costs were 10.2% higher than the national average.

Based on the results of the review, Vaudt recommended:

- The Legislature establish controls over compensation practices of all State Authorities, including the Iowa Lottery, to ensure Authority status does not result in salaries which

are not based on employee responsibilities, experience and other valid documented considerations. In addition, the Legislature, which authorized key personnel positions in the Iowa Lottery's enabling legislation, should determine if it is necessary to maintain key positions.

- The Legislature conduct a comparison of all State Authority personnel salaries with State agency personnel salaries to identify any other salary anomalies.
- The Iowa Lottery Board work with the Department of Administrative Services to conduct an independent compensation review, including State personnel operating in similar positions as well as state lotteries with comparable state populations, demographics and revenues. The independent compensation review should include consideration of cost of living and employee benefits.
- The Iowa Lottery CEO and Board review current key personnel salaries at the Iowa Lottery to determine whether they are appropriate after the Board's independent compensation review is completed.

A copy of the report is available for review in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/specials/1160-6270-B0P0.pdf>.

# # #

**A REVIEW OF THE  
IOWA LOTTERY AUTHORITY  
FOR THE PERIOD  
JULY 1, 2002 THROUGH JUNE 30, 2010**

## Table of Contents

	<b><u>Page</u></b>
Auditor's Transmittal Letter	3-4
Executive Summary	5-8
Background	9-12
Objectives, Scope and Methodology	12
Detailed Findings:	
Lottery Operations as an Authority	12-17
Trends in Salaries Since Becoming an Authority:	
Compensation Review	18-25
Key Personnel	25-28
Iowa Lottery Key Personnel Salary Adjustments	28-36
Other Iowa Lottery Employees	36-37
State Lottery Comparative Analysis	37-43
Conclusions and Recommendations	43-44
Schedule:	<u>Schedule</u>
Annual Base Salaries in Excess of State Pay Plan	1 46-53
Staff	54
Appendices:	<u>Appendix</u>
Excerpt from Compensation Review	A 56-59
Excerpt from June 18, 2004 Iowa Lottery Board Meeting Minutes	B 60
Iowa Lottery Board for Fiscal Years 2003 through 2010	C 61
List of Acronyms	D 62
Iowa Lottery's Response	E 63



**OFFICE OF AUDITOR OF STATE**  
**STATE OF IOWA**

David A. Vaudt, CPA  
Auditor of State

State Capitol Building  
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

Auditor's Transmittal Letter

To the Governor, Members of the General Assembly, Members of the  
Iowa Lottery Board and the Director of the Iowa Lottery Authority:

In conjunction with our audit of the financial statements of the State of Iowa and in accordance with Chapter 11 of the *Code of Iowa*, we conducted a review of the Iowa Lottery Authority (Iowa Lottery). Our review included procedures to determine the impact of the Iowa Lottery becoming an Authority.

We have applied certain tests and procedures to selected processes and financial information for the period July 1, 2007 through June 30, 2010. Based on a review of relevant information, the *Code* and administrative rules governing the Iowa Lottery, we performed the following procedures:

- (1) Interviewed Iowa Lottery officials to obtain an understanding of the current procedures and general Iowa Lottery operations and to obtain pertinent information regarding industry operations.
- (2) Reviewed applicable laws, rules and guidelines.
- (3) Researched other state lotteries to collect comparable data and performed comparative analyses to determine the Iowa Lottery's effectiveness when compared to other state lotteries operating as Authorities or operating with similar populations.
- (4) Reviewed salaries of Iowa Lottery officials over time and compared salary amounts to other state lottery salaries and other employees of the State of Iowa with consideration to job duties to compare salaries and salary increases over time.
- (5) Analyzed activities which resulted in increased revenues after the Iowa Lottery became an Authority to determine whether those activities could have been conducted if the Iowa Lottery had remained a state agency.
- (6) Evaluated documentation provided by Iowa Lottery officials as a basis for increased salaries and program improvements resulting from becoming an Authority to determine whether the support was adequate to justify increased salaries and the benefits of the Iowa Lottery becoming an Authority.
- (7) Interviewed the consultant who conducted the compensation review utilized by the Iowa Lottery to justify key personnel salary increases when the Iowa Lottery became an Authority.
- (8) Reviewed Iowa Lottery Board meeting minutes to obtain information regarding certain changes to key personnel salaries.

Based on these procedures, we determined revenues and associated transfers to the State of Iowa significantly increased in the years after the Iowa Lottery became an Authority. However, these increases were not a result of the Iowa Lottery becoming an Authority. While some of the increases may have been a result of certain activities which were initiated more quickly because the Iowa Lottery was an Authority instead of a state agency, the activities could have also been carried out if the Iowa Lottery had remained a state agency. The Iowa Lottery did not provide sufficient information to demonstrate what portion, if any, of the increases was due to the Iowa Lottery's status as an Authority.

In addition to its ability to change business strategies more quickly to generate more revenues, the Iowa Lottery's status as an Authority allowed it to set key personnel salaries. With its ability to establish key personnel salaries, the Iowa Lottery significantly increased the salaries of key personnel and upgraded positions in a relatively short time. This resulted in substantially higher salaries for personnel serving in the same position. Iowa Lottery representatives explained higher salaries were necessary to be competitive and retain key personnel. However, after our review of historical retention of key personnel at the Iowa Lottery, we determined the minimal turnover at the Iowa Lottery was not sufficient to warrant significant salary increases for all key personnel at the Iowa Lottery.

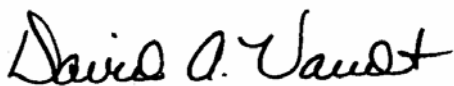
In addition, Iowa Lottery officials stated the Iowa Lottery's entrepreneurial operating practices made comparison to state agency salaries improper. Therefore, when the Iowa Lottery became an Authority, it conducted a compensation review which included salaries from the private sector and nonprofit entities as well as a small selection of state lotteries deemed to be appropriate for comparison to the Iowa Lottery due to their similar operating style. When the compensation review was completed, the Iowa Lottery used certain parts of the review to justify significantly increased key personnel salaries over just a two-year period. We determined the basis of the compensation review the Iowa Lottery relied on to increase salaries was flawed in its design and virtually guaranteed salary increases would be recommended as a result of the compensation review.

By becoming an Authority, the Iowa Lottery was to be operated in "an entrepreneurial and businesslike manner" to provide continuing entertainment to the public while maximizing revenues for the State. However, the Iowa Lottery has continued to function in essentially the same manner it functioned prior to becoming an Authority. Designating the Iowa Lottery as an Authority should not eliminate critical oversight or reward Iowa Lottery employees with higher salaries. Non-Authority entity employees performing key services to the State also have significant responsibilities. Iowa Lottery employees should not be eligible for higher salaries simply because the Iowa Lottery's function is to bring in revenue.

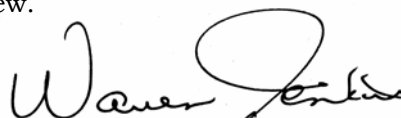
When compared to other state lotteries, both operating as state agencies and operating as Authorities, the Iowa Lottery had disproportionately higher administrative costs than comparable state lotteries. We identified state lotteries which generated less revenue than the Iowa Lottery but still contributed more to their states' General Funds due to lower administrative costs. Iowa Lottery representatives provided information on key factors affecting the Iowa Lottery's ability to generate revenues in comparison to other state lotteries, but we determined most of the factors discussed could affect many state lotteries and were not unique to Iowa. For example, many state lotteries compete with casinos for gaming revenues within their states and many states have rural areas for which operating costs are higher than metropolitan areas.

We have also developed certain recommendations and other relevant information we believe should be considered by the Iowa Lottery Authority, the Governor and the General Assembly.

We extend our appreciation to the personnel of the Iowa Lottery Authority for the courtesy, cooperation and assistance provided to us during this review.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

April 6, 2012



## EXECUTIVE SUMMARY

From 1985 to 2003, the Iowa Lottery operated as a State agency and was subject to rules and regulations applicable to all other state agencies. However, effective September 1, 2003, the Legislature established the Iowa Lottery Authority (Iowa Lottery). As an Authority, the Iowa Lottery is not subject to general state government rules and regulations applicable to state agencies. This review included evaluation of certain Iowa Lottery activities for the period July 1, 2002 through June 30, 2010 and was conducted to determine the impact of the Iowa Lottery becoming an Authority.

Since fiscal year 2004, the first year the Iowa Lottery became an Authority, annual revenues for the Iowa Lottery have increased. However, the support provided by officials at the Iowa Lottery was not sufficient to demonstrate the increased revenues realized by the Iowa Lottery were a result of the Iowa Lottery becoming an Authority. When comparing revenue increases at the Iowa Lottery to revenue increases at other state lotteries which continued to operate as state agencies, the revenue increases were consistent across the board and the Iowa Lottery did not produce larger revenue increases than other state lotteries which continued to operate as state agencies. All the activities which resulted in increased revenues could have been conducted if the Iowa Lottery had remained a state agency. Although certain revenue-generating activities may have been implemented more quickly due to the Iowa Lottery's status as an Authority, each of the activities resulting in significant revenues was permissible for the Iowa Lottery to conduct as a state agency.

The Iowa Lottery's status as an Authority has also allowed the Iowa Lottery to make significant changes to its compensation practices for personnel the Iowa Lottery determines to be key to the organization. In accordance with the *Code of Iowa*, the Iowa Lottery's Chief Executive Officer (CEO), with approval from the Iowa Lottery Board, has power to designate particular employees as "key personnel." Of the key personnel, the CEO is appointed by the Governor and compensation and employment terms for the CEO are set by the Governor. Other key personnel are exempt from the State's classification system and pay plan and their salaries are set by the Iowa Lottery.

As a result of the Iowa Lottery becoming an Authority:

- The Legislature no longer established a salary range for the Iowa Lottery CEO, as it did for Department Directors, with salaries being determined by the Governor within the salary range. Because a salary range was not established for the Iowa Lottery CEO, Governor Vilsack and Governor Culver approved salary increases for the Iowa Lottery CEO during the 6 fiscal years from fiscal year 2005 through fiscal year 2010. The approved annual salary for the Iowa Lottery CEO over the period totaled \$358,856.43 more than would have been possible if the Legislative salary range used before the Iowa Lottery became an Authority had been maintained.
- Governor Vilsack and Governor Culver approved incremental salary increases for the prior Iowa Lottery CEO from \$122,811.38 in fiscal year 2003 to \$239,777.46 (a 95% increase) in fiscal year 2008, when he retired. In addition, when the prior Iowa Lottery CEO retired, he began receiving significantly higher IPERS benefits for the duration of his life because of the salary increases he received when the Iowa Lottery became an Authority. According to IPERS, the prior Iowa Lottery CEO's IPERS benefits are nearly 60% higher than the IPERS benefits he would have received had the Iowa Lottery remained a state agency.
- The Iowa Lottery has increased the salaries of other key personnel to amounts significantly higher than the maximum salary amounts key personnel would have been eligible to receive if the Iowa Lottery had remained a state agency. The increase in annual approved salaries of the other 8 employees designated as key personnel was estimated to be \$589,429.23 more than would have been possible if the State's salary ranges for the 8 positions had been maintained during the 6 years from fiscal year 2005 through fiscal year 2010.

- From fiscal year 2005 to fiscal year 2010, the total salaries approved for the Iowa Lottery CEO and key personnel in excess of the State's pay plan totaled \$948,285.66. The additional payroll contributions associated with those approved salaries total \$87,175.32. Accordingly, since becoming an Authority, the authorized salaries in excess of the maximum allowable under the State's pay plan for the Iowa Lottery CEO and key personnel plus the related payroll contributions is over \$1 million.
- The Iowa Lottery hired a consulting firm to conduct a compensation review in 2004 after the Iowa Lottery became an Authority. However, the compensation review utilized compensation of personnel at entities not comparable to the Iowa Lottery as its benchmark, which virtually guaranteed Iowa Lottery key personnel salaries would appear low. The compensation review primarily utilized private sector and nonprofit entities as the basis of its market salary calculation for each key position included in the review. In addition, the compensation review did not analyze employee benefits or cost of living, which can significantly impact the results.

While the compensation review also included salary data from 7 state lotteries, according to the consultant, the prior Iowa Lottery CEO directed the consultant to exclude all state lotteries which operated as state agencies from the compensation review. Therefore, only non-state agency lotteries were included in the compensation review. According to an article published in 2009, all 7 CEO's of the state lotteries included in the compensation review were among the highest paid state lottery CEO's in the country. In addition, most of the 7 state lotteries included in the compensation review had larger state populations and larger revenues than the Iowa Lottery. Other state lotteries which were more comparable to the Iowa Lottery in terms of geographical location, state population and lottery revenues were excluded from the review because they did not function as Authorities.

The compensation review recommended increasing the maximum salary potential for key personnel included in the review. The Iowa Lottery increased salary maximums in accordance with the compensation review recommendations except the Lottery increased 1 key personnel position to an amount even higher than the compensation review recommendation. The Iowa Lottery approved and implemented raises increasing key personnel salaries to the maximum allowance for each position within just a 2-year period. However, the consultant who conducted the compensation review stated her recommendation was to establish larger salary ranges to allow for gradual salary growth based on performance and longevity. The consultant stated implementing across-the-board salary increases to the maximum in the salary ranges recommended in a 2-year period was not a practice she supported. Doing so eliminated the ability to adjust salaries based on performance and longevity, which was the consultant's reason for recommending larger pay ranges and higher maximum salaries.

- The Iowa Lottery Board inappropriately delegated the compensation review to Lottery officials who would be financially impacted by the results of the review. The delegation created several issues with critical parameters of the compensation review which caused flawed compensation review results and inadequately justified key personnel salaries. It appears the Iowa Lottery Board failed to properly exercise its fiduciary responsibilities in determining and approving appropriate key personnel salaries.
- Iowa Lottery key personnel received significantly larger base salary increases and larger overall salaries than their counterparts in other entities within the State from fiscal year 2003 through fiscal year 2009. The most significant increases occurred after the Iowa Lottery became an Authority. After 2 years as an Authority, the prior Iowa Lottery's CEO salary increased 68.55%. During the first 3 years the Iowa Lottery was an Authority, the prior CEO's base salary increased by 75.68%. In contrast, during that same period, the Executive Director of the Iowa Finance Authority received a base salary increase of only 7.71%. By comparing the prior Iowa Lottery CEO's base salary to comparable positions at other larger State entities, it is readily apparent the Iowa Lottery outpaced other State entities in regard to pay increases and total base pay for the CEO.

Other Iowa Lottery key personnel also receive larger salaries than their counterparts at larger State entities. For example, in fiscal year 2009, the Iowa Lottery Vice President of External Relations received a base salary of approximately \$117,500.00. If the Iowa Lottery had remained a state agency, its Vice President of External Relations would have been eligible for a maximum salary of \$89,710.40 for fiscal year 2009. At the time, the Vice President of External Relations was 1 of 6 Vice Presidents in the 109-employee Iowa Lottery. As a comparison, the Division Director of the Division of Mental Health and Disability Services at the Department of Human Services (DHS) also received a salary of approximately \$117,500.00. However, at that time, the Division Director was 1 of 6 Division Directors in the 5,767-employee DHS – a Department with 53 times as many employees as the Iowa Lottery.

In the first 2 years of the Iowa Lottery's status as an Authority (fiscal years 2004 and 2005), a time when Iowa Lottery key personnel salaries increased substantially, a majority of State Department Directors included in our review did not receive any salary increases. A majority of the State Division Directors included in the review recognized salary increases ranging from 6.12% to 13.38%. As previously stated, during this 2-year period, the prior Iowa Lottery CEO received a 68.55% salary increase. In addition, Iowa Lottery key personnel received salary increases ranging from 13.86% to 27.55%.

- When the Iowa Lottery became an Authority, it created the Executive Secretary position and increased the salary range of this key personnel position. However, when the Executive Secretary retired in fiscal year 2009, the Iowa Lottery did not fill the position. Instead, Iowa Lottery officials requested, and the Iowa Lottery Board approved, reducing the Executive Secretary salary range back to the prior range, even though the duties of the position remained unchanged. However, according to Iowa Lottery Board minutes, the Iowa Lottery later reinstated the previous higher salary range, justifying reinstatement of the higher salary by increasing the duties and responsibilities of the position. If increased duties and responsibilities were necessary to justify reinstating the higher salary range for the Executive Secretary position, the initial increase should not have been approved just because an experienced and valued employee held the position.
- Some Iowa Lottery personnel receive more compensation than comparable State entity personnel, even though the Iowa Lottery has continued to operate in essentially the same manner as it did prior to becoming an Authority. Making the Iowa Lottery an Authority has given the Iowa Lottery CEO the flexibility to reward key personnel in a manner unavailable to Directors at other State entities. As a result, there is an appearance Iowa Lottery personnel are more valued than other State employees.
- A primary function of the Iowa Lottery is to generate revenues to transfer to the State's General Fund. As such, it is reasonable to assume each state lottery CEO's ability to generate revenues to transfer to its state would be a factor in establishing the CEO's salary. The current Iowa Lottery CEO's salary for 2009, while substantially lower than his predecessor's 2008 salary, is significantly higher than a majority of other state lottery CEOs. However, according to statistical information reviewed for all U.S. state lotteries for fiscal year 2009, the Iowa Lottery transferred fewer funds to the State's General Fund as a percentage of ticket sales than a majority of other state lotteries. The current Iowa Lottery CEO's salary during that fiscal year was among the highest in the country according to a newspaper article published during that time.

Due to variances in potential revenues based on population, we compared Iowa Lottery transfers to the State to 7 other state lotteries with similar populations. Based on the comparison conducted, the Iowa Lottery transferred the lowest percentage of its revenues to the State. Of the 7 other state lotteries selected for the comparison, 5 state lotteries produced larger sales per capita. The 2 state lotteries with smaller sales, both per capita and in total, transferred larger amounts to their respective states, both per capita and in total. The Iowa Lottery's operating expenses as a percentage of sales were the highest and its transfers to the State were the lowest within the 7 state lotteries reviewed. However, the

current Iowa Lottery CEO received a higher salary in fiscal year 2009 than 3 of the state lotteries reviewed.

According to certain U.S. Census data for fiscal year 2007, the Iowa Lottery's sales per capita were 58.5% lower than the national average and administrative costs were 10.2% higher than the national average. In addition, the state lotteries which operated with lower sales per capita also had lower administrative costs than the Iowa Lottery. However, in fiscal year 2009, the current Iowa Lottery CEO was the 9<sup>th</sup> highest paid CEO of 44 state lotteries included in a newspaper article.

- Officials at the Iowa Lottery provided documentation summarizing factors which impact comparisons between state lotteries. The prior Iowa Lottery CEO developed the documentation 15 years earlier and stated it is impossible to compare the performance of state lotteries due to unique factors such as state laws, demographics, population and availability of other gambling options. In addition, Iowa Lottery officials stated distribution costs and availability of other gambling options are significant factors affecting revenues at the Iowa Lottery. Although we determined many of the factors discussed could potentially impact state lottery performance, the impact on each state lottery would vary depending on the specific conditions of each state. Such factors do not render comparisons between state lotteries meaningless.

Based on the results of the review:

- The Legislature should establish controls over compensation practices of all State Authorities, including the Iowa Lottery, to ensure Authority status does not result in salaries which are not based on employee responsibilities, experience and other valid documented considerations. In addition, the Legislature, which authorized key personnel positions in the Iowa Lottery's enabling legislation, should determine if it is necessary to maintain key positions.
- The Legislature should conduct a comparison of all State Authority personnel salaries with State agency personnel salaries to identify any other salary anomalies.
- The Iowa Lottery Board should work with the Department of Administrative Services to conduct an independent compensation review, including State personnel operating in similar positions as well as state lotteries with comparable state populations, demographics and revenues. The independent compensation review should include consideration of cost of living and employee benefits.
- The Iowa Lottery CEO and Board should review current key personnel salaries at the Iowa Lottery to determine whether they are appropriate after the Board's independent compensation review is completed.

## BACKGROUND

The Iowa Lottery was established in 1985 to generate revenues to be transferred to the General Fund of the State to support a variety of programs and services. The Iowa Lottery has distributed more than \$2.5 billion in prizes and has raised more than \$1.2 billion for state programs from 1985 to 2010. **Table 1** summarizes Iowa Lottery financial activity for the last 11 fiscal years (in millions).

**Table 1**

<b>Fiscal Year</b>	<b>Revenues</b>	<b>Prizes</b>	<b>Expenses~</b>	<b>To State</b>	<b>Percent of Revenues to State</b>
2000	\$ 169.7	98.4	35.0	36.3	21.4%
2001	168.4	96.7	35.8	35.9	21.3%
2002	175.5	100.0	36.0	39.5	22.5%
2003	180.0	104.2	36.8	39.0	21.7%
2004	209.9	114.5	39.6	55.8	26.6%
2005	211.0	113.5	46.4	51.1	24.2%
2006^	340.9	122.3	137.7	80.9	23.7%
2007	235.2	133.4	43.6	58.2	24.7%
2008	249.3	144.7	48.1	56.5	22.7%
2009	243.4	138.4	44.4	60.6	24.9%
2010	256.3	150.5	47.9	57.9	22.6%

~ - The expenses amount is the net total of expenses, changes to net assets and other revenues.

^ - Large increases primarily due to introduction of TouchPlay, a video monitor vending machine. TouchPlay was introduced in fiscal year 2005 but was later prohibited by law by the end of fiscal year 2006.

Revenues in fiscal year 2010 have increased over 51% since fiscal year 2000 and expenses have increased 36.8% from fiscal year 2000 to fiscal year 2010. Transfers to the State have ranged from 21.3% to 26.6% of revenues during the last 11 years. The transfers to the State have been designated primarily to the State's General Fund, but the transfers have also included significant funds for the Gambling Treatment Fund and the Veterans Trust Fund.

From 1985 to 2003, the Iowa Lottery operated as a state agency and was subject to rules and regulations applicable to all other state agencies. For example, Iowa Lottery employee salaries were regulated through the same classification system and pay plan as all other state employees.

Effective September 1, 2003, the Legislature established the Iowa Lottery Authority (Iowa Lottery), a public instrumentality of the State, no longer defined as a state agency. As an Authority, the Iowa Lottery is not subject to general state government rules and regulations applicable to state agencies. However, the Iowa Lottery is still treated as a state agency for the purposes of:

- Iowa Administrative Procedures Act
- Open Meetings Law
- Public Records Law
- Intergovernmental Agreements
- Personnel Files Access by Employees
- IPERS
- Group Health Insurance
- Liability Coverage

In accordance with Chapter 99G of the *Code of Iowa*, the Iowa Lottery was designed to have comprehensive and extensive powers to operate in an entrepreneurial and businesslike manner. The *Code* states the Iowa Lottery's games "shall be operated and managed in a manner that provides continuing entertainment to the public, maximizes revenues, and ensures that the lottery is operated with integrity and dignity and free from political influence." In accordance with the *Code*, the Iowa Lottery is allowed to:

- Sue and be sued and to complain and defend in all courts,
- Adopt and alter a seal,
- Procure or to provide insurance,
- Hold copyrights, trademarks, and service marks,
- Initiate, supervise, and administer the operation of the lottery,
- Enter into written agreements with other states or entities,
- Conduct market research,
- Acquire or lease real property and make improvements,
- Enter into contracts to incur debt in its own name or debts of any kind,
- Establish and maintain banking relationships,
- Act as a retailer,
- Advertise and promote the lottery and lottery games and
- Purchase any real property or borrow up to one million dollars without consent of the Executive Council.

In accordance with the *Code*, the Iowa Lottery is accountable to the Governor, the General Assembly and the people of the State through a system of audits, reports, legislative oversight and financial disclosures. For example, the Iowa Lottery is required to submit quarterly and annual reports to the Governor, Auditor of State and General Assembly disclosing the total lottery revenues, prize disbursements and other expenses of the Authority during the reporting period. In addition, the Iowa Lottery is required to submit a proposed operating budget to the Department of Management each year for informational purposes.

In fiscal year 2010, the Iowa Lottery operated with approximately 114 employees in the areas of security, finance, operations, sales, marketing and external relations. Total employees include approximately 47 assigned to the Iowa Lottery Headquarters in Des Moines for program administration. There is also an Iowa Lottery warehouse facility in Ankeny and sales representatives, regional managers and support staff working out of 5 regional offices. Iowa Lottery employees are eligible for insurance, retirement and liability coverage through the State. The Chief Executive Officer's (CEO's) salary is set by the Governor, but all other key personnel salaries are determined by the CEO and Iowa Lottery Board.

The Iowa Lottery distributes its gaming products to approximately 2,500 licensed retail outlets across the State. Pursuant to the Iowa Administrative Code, Iowa Lottery gaming products (Scratch, Pull-tab and Lotto tickets) may be sold at any retailer having a license to sell alcohol or tobacco and may not be sold to individuals under the age of 21. Each outlet has computer equipment for ticket validation linked through a communications network to a central ticketing system operated by the Iowa Lottery's online vendor, Scientific Games.

A majority of the states in the United States operate a lottery. The North American Association of State and Provincial Lotteries (NASPL) includes 44 states and Washington D.C. in its list of United States lotteries. Each lottery is designed to provide revenues to support state programs, but each is structured differently in accordance with individual state requirements. For example, some states require the lotteries to function as state agencies while other states, including Iowa, manage their state lotteries as corporations or Authorities operating separately from the State.

In addition to the Iowa Lottery, there are several other entities within the State which operate as Authorities. Other Authorities within the State include:

Agricultural Development Authority – The Agricultural Development Authority was established for the purpose of providing financial assistance to grain and livestock producers in Iowa. The Agricultural Development Authority is governed by a 9-person Board of Directors serving alternating 6-year terms. According to state payroll records at the end of fiscal year 2010, the Authority had 8 authorized positions and 5 were filled at that time. The Authority compensates its employees in accordance with the State's pay plan and the employees receive the same benefits package. Authority personnel, with the exception of principal administrative assistants, are required to be under the State's merit system.

Advance Funding Authority - The Advance Funding Authority was established for the purposes of reducing the cash flow difficulties faced by Iowa schools, improving the financial procedures of Iowa schools and reducing the short-term borrowing costs of Iowa schools. The powers of the Advance Funding Authority are vested in a 5-member Board. In accordance with the Iowa Administrative Code, the Iowa Finance Authority provides the personnel necessary to manage the Authority and no independent personnel for the Authority exists.

Iowa Finance Authority – The Iowa Finance Authority's (IFA) mission is to finance, administer, advance and preserve affordable housing and to promote community and economic development for Iowans. IFA is a self-supporting public agency. The powers of the IFA are vested in a 9-member Board. The IFA Executive Director and the Board are appointed by the Governor and the Director's salary is established by the *Code of Iowa*. IFA had 82 employees at the end of fiscal year 2010 and utilizes the State's pay plan to compensate its employees. In accordance with section 16.6 of the *Code of Iowa*, all IFA employees are exempt from the merit system. The employees receive the same benefits package as other state employees.

Iowa Higher Education Loan Authority – The Iowa Higher Education Loan Authority is created as a body politic and corporate and is attached to the College Student Aid Commission for administrative purposes. The powers of the Iowa Higher Education Loan Authority are vested in a 5-member Board. According to the Executive Director, she was the only employee on staff at the end of fiscal year 2010. Her salary is established by the Board. The Authority does not utilize the State's pay plan and its employee does not receive the State's benefits package.

State Fair Authority – The State Fair Authority is a public instrumentality of the State. However, according to the *Code of Iowa*, the Authority is treated as a state agency for those purposes specified previously for the Iowa Lottery. The State Fair Authority was established to conduct an annual state fair and exposition and to conduct other interim events. The powers of the State Fair Authority are vested in the State Fair Board. The Director's salary is set by the State Fair Board with the approval of the Governor. The State Fair Authority had 59 employees at the end of fiscal year 2010 and does not compensate its employees based on the State's pay plan. However, the *Code* specifies the employees are state employees and receive the same benefits package as other state employees.

Economic Development Authority – The Economic Development Authority was established July 1, 2011 and replaced the Department of Economic Development. According to legislation, the Economic Development Authority is governed by an 11-member Board appointed by the Governor. In addition, the Governor selects the Director, who is responsible for hiring the personnel necessary to carry out the duties of the Authority. According to a representative of the Economic Development Authority, all staff, including the Director, are compensated through the State's pay plan.

Each Authority is exempt from the State's merit system requirements. We did not evaluate the salary structures of these Authorities as part of this review. Exemptions from the merit system are not restricted to Authorities. The *Code* includes a number of exemptions, such as employees in the Legislative and Judicial Branches, elected officials and their employees and members of the State Patrol.

## OBJECTIVES, SCOPE AND METHODOLOGY

To evaluate the impact of the Iowa Lottery becoming an Authority, we evaluated the effectiveness of operations and controls by conducting comparative analyses to identify changes in operating costs before and after the Iowa Lottery became an Authority. In addition, we compared lottery Authorities to non-Authorities to determine whether Authority status provided for greater effectiveness.

To determine whether the Iowa Lottery is actively controlling its costs to maximize the funds to be transferred the State's General Fund, we compared certain Iowa Lottery operating costs to those of other state agencies.

To determine whether the Iowa Lottery is operating as effectively and efficiently as other comparable state lotteries, we conducted comparative analyses to determine whether the Iowa Lottery was generating profits consistent with its size.

## DETAILED FINDINGS

Revenues and corresponding transfers to the State's General Fund have significantly increased since fiscal year 2003, the final year the Iowa Lottery functioned as a state agency. However, the Iowa Lottery was unable to provide sufficient support to demonstrate its status as an Authority is the reason revenues have increased in the past 7 years. As a result of its Authority status, the Iowa Lottery has increased key personnel salaries and upgraded positions in a relatively short time. In addition, the Iowa Lottery has some of the highest administrative costs in the nation when compared on a per capita basis to the administrative costs of other state lotteries.

### Lottery Operations as an Authority

As previously stated, the Iowa Lottery became an Authority in fiscal year 2004. As a result of being an Authority, the Iowa Lottery has comprehensive and extensive powers to operate in an entrepreneurial and businesslike manner with the purpose of generating revenues to transfer to the State's General Fund. According to the Iowa Lottery Annual Report for fiscal year 2010, the Iowa Lottery's reorganization to establish it as an Authority has resulted in more efficient operations and has resulted in continued growth of sales since becoming an Authority. **Table 2** is a summary of the Iowa Lottery's operating revenues and expenses (in millions) comparing operations from fiscal year 2003, prior to becoming an Authority, and fiscal years 2004 through 2010, when operating as an Authority.

**Table 2**

Category	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10
Operating revenues	\$180.1	209.9	211.0	340.9	235.2	249.3	243.4	256.3
Operating costs	142.2	155.1	159.4	259.3	177.1	192.0	184.5	198.9
Revenues transferred to State	39.0	55.8	51.1	80.9	58.2	56.5	60.6	57.9
Percent of revenues transferred to State	21.7%	26.6%	24.2%	23.7%	24.7%	22.7%	24.9%	22.6%

As demonstrated in the **Table**, transfers to the State have substantially exceeded the fiscal year 2003 transfer. Over the 7-year period after fiscal year 2003, the average annual transfer to the State is \$60.1 million, which is \$21.1 million more than the fiscal year 2003 transfer to the State.



While the amount transferred has increased, the percentage of revenues transferred to the State's General Fund has remained relatively constant, ranging from 22.6% to 26.6%.

In fiscal year 2006, total revenues increased and operating costs and transfers to the State increased at a similar rate. The increase in revenues was primarily due to the popularity of TouchPlay, which was a machine-based gaming system located in approximately 6,000 bars, restaurants, convenience stores and grocery stores in the State. In its first year of operation in fiscal year 2004, net revenues for TouchPlay were \$303,079.00. From fiscal year 2004 to fiscal year 2005, net revenues increased over \$6 million to \$6,428,123.00. At the end of fiscal year 2006, net revenues for TouchPlay increased to \$121,450,629.00, which was an increase of \$115,022,406.00 from fiscal year 2005. In its 3 years of operation, TouchPlay revenues grew from less than 1% of total revenues in fiscal year 2004 to 36% of total revenues in fiscal year 2006. Net revenues are after deducting prize expenses.

Due to controversy regarding the availability and controls over usage of TouchPlay, the General Assembly passed Senate File 2330 (TouchPlay Act) on March 14, 2006 and the Governor signed the Act on March 20, 2006. This resulted in a ban on use of the TouchPlay Monitor Vending Machine product. Therefore, fiscal year 2006 was the final year TouchPlay revenues were recognized by the Iowa Lottery.

We evaluated the increases in revenues to determine whether those revenue increases were realized as a result of becoming an Authority or if the revenue increases could have been realized if the Iowa Lottery did not become an Authority. In most cases, the revenue increases were a result of activities the Iowa Lottery conducted which were not contingent on the Iowa Lottery being an Authority. For example, adding over 260 new retailers in fiscal year 2005 resulted in significant revenues. Although Iowa Lottery officials stated they were able to add new retailers more quickly, the Iowa Lottery's former status as a state agency would not have precluded the Iowa Lottery from increasing the number of retailers.

Iowa Lottery officials stated the following are examples of business decisions the Iowa Lottery was able to make as an Authority, which resulted in significant savings and revenue generation.

- Headquarters and equipment purchase in fiscal year 2004 – According to Iowa Lottery officials, the Legislature would not permit procurement of a headquarters building when the Iowa Lottery operated as a state agency. However, when the Iowa Lottery became an Authority, the Iowa Lottery Board authorized and the Executive Council approved issuance of \$8.8 million in revenue bonds to pay for the purchase, financing and renovation of real property for use as the Iowa Lottery headquarters. In addition, the revenue bonds also paid for installation and financing of 1,300 lottery ticket vending machines. Iowa Lottery officials stated this action resulted in saving approximately \$1.8 million over the period of time the Iowa Lottery would have been leasing vending equipment and leasing its headquarters facility had it not purchased the lottery ticket vending machines and headquarters building. Iowa Lottery officials also stated the Iowa Lottery will continue to realize savings on the purchase of the headquarters building in comparison to the leasing costs previously paid and have extended the use of the lottery ticket vending machines past the anticipated useful life, which has resulted in additional savings.

While we agree the purchase of a building rather than leasing did result in a long-term savings, the Iowa Lottery had the ability to purchase a building as a state agency with appropriate Legislative action. While the General Assembly did not approve the real property purchase at the time initially requested, it may have at a future date.

- Quick response to Casey's General Stores® in 2004 – According to Iowa Lottery officials, Casey's General Stores® expressed interest in selling lottery tickets in fiscal year 2004. Because the Iowa Lottery Board and CEO had control over Iowa Lottery budgeting decisions, the Iowa Lottery was able to act quickly to invest \$1.8 million in the necessary equipment to

prepare all 335 Casey's General Stores® locations to sell its products and Casey's General Stores® prioritized Iowa in its lottery ticket implementation process, which led to significantly increased retailers selling Iowa Lottery tickets. According to Iowa Lottery officials, the Iowa Lottery's ability to act quickly resulted in completion of the expansion 2 years faster than would have been possible if the Iowa Lottery had been a state agency, which Iowa Lottery officials stated resulted in \$29 million in additional revenues during the 2-year period. However, based on review of the *Code* and discussion with Department of Management officials, we disagree operating as a state agency would have delayed ticket sales in Casey's General Stores®.

According to Chapter 99E of the 1999 *Code*, before the Iowa Lottery became an Authority, the Iowa Lottery's Commissioner was authorized, with approval from the Iowa Lottery Board, to enter into contracts for lottery operations. The *Code* also described how revenues generated by the Iowa Lottery were to be used, which included operating expenses resulting from contracts entered into by the Iowa Lottery and expenses related to the purchase or lease of lottery equipment, tickets and materials. Revenues remaining after payment of operating expenses and other allocations were transferred to the State's General Fund. Therefore, there is no reason the \$29 million in revenues Iowa Lottery officials stated were realized in the first 2 years tickets were sold at Casey's General Stores® could not have also been realized if the Iowa Lottery had remained a state agency.

- Mid-year adjustments to marketing plans and budgets – Because the Iowa Lottery has the ability to adjust its budget quickly and can increase budgeted total costs as an Authority, Iowa Lottery officials stated the Iowa Lottery was able to position itself to quickly introduce and market new products and make the necessary budgeting changes to prepare for new products. Examples include:

- Quarter Play, introduced in fiscal year 2005, was the world's first electronic instant-scratch product and won a product-of-the-year award for the Iowa Lottery, producing additional lottery sales and profits during that time period.

Iowa Lottery officials did not quantify the benefit related to quick release of this product. At the time of our review, Quarter Play was not sold by the Iowa Lottery. Actual revenues recognized as a result of quicker release of a product-of-the-year award winning product were not provided.

- Lucky 7s, introduced in fiscal year 2006, was the Iowa Lottery's first game to combine instant-scratch and pull-tab tickets into 1 product and won a product-of-the-year award for the Iowa Lottery, producing additional lottery sales and profits during that time period.

Iowa Lottery officials did not quantify the benefit related to quick release of this product. At the time of our review, Lucky 7's was not sold by the Iowa Lottery. Actual revenues recognized as a result of quicker release of a product-of-the-year award winning product were not provided.

- Mega Millions, introduced in fiscal year 2010, was a nationwide gaming product the Iowa Lottery was able to begin marketing at the earliest point possible, contrary to other states which were forced to delay introduction of the product. In fiscal year 2010, Mega Millions grossed \$5.5 million in sales.

Iowa Lottery officials did not quantify the benefit related to quicker release of this product.

Iowa Lottery officials stated there was a political expectation an old lottery game would end each time a new lottery game was introduced. There was not a specific requirement outlining this expectation in the *Code*. However, Iowa Lottery officials stated this was an expectation from the Legislature and the Governor's Office and it reduced the Iowa Lottery's flexibility and ability to provide a variety of games to current customers and to attract new customers. When the Iowa Lottery became an Authority, Iowa Lottery officials stated the Iowa Lottery was no longer constrained by those expectations. However, since the expectation was not in the *Code* or any other written requirements provided by the Iowa Lottery, it was not necessary for the Iowa Lottery to become an Authority to avoid the unwritten expectations.

In addition, as previously demonstrated, state agencies have discretionary authority to adjust their budgets during the year to adjust for unforeseen changes.

- Mid-year adjustments to revenue estimates – Iowa Lottery officials stated economic downturns and flooding of lottery retailer locations in eastern Iowa in fiscal years 2008 and 2009 led to a need to adjust budget estimates midyear. Because the Iowa Lottery was an Authority, Iowa Lottery officials were able to adjust budget estimates to increase costs and were able to report adjustments to state lawmakers during the 2009 legislative session. The ability to increase budgets is unique to state entities not subject to budget limitations. While this ability may be helpful to the Iowa Lottery, it could also result in decreased accountability for use of funds which, if saved, could potentially increase revenues transferred back to the State.
- Emergency-preparedness protection – Iowa Lottery officials stated the Iowa Lottery's status as an Authority allows it to borrow money in the event of a disaster which requires more than the minimal cash on hand at the Iowa Lottery. For example, Iowa Lottery officials we spoke with stated if the Iowa Lottery had immediate need to replace computer equipment at a cost greater than the reserve amounts on hand, the disaster could be financially fatal to the Iowa Lottery.

The likelihood of such events does not appear to represent significant risk and we do not believe reducing oversight and accountability to the Governor and the Legislature to allow the Iowa Lottery to take on debt in the event of such emergencies is justified. In addition, if the additional protection is essential, State entities integral to State operations would have a greater need for such protection than the Iowa Lottery, given the nature of the services they provide. Further, the Iowa Lottery receives insurance benefits through the State for losses related to motor vehicle fleet, property damage and torts and has also purchased commercial insurance for certain risks, according to its financial statements.

The Iowa Lottery official we spoke with also stated Authority status protects the State of Iowa from potential lawsuits because the Iowa Lottery operates completely separately from the State of Iowa. For example, for the multistate gaming products sold in Iowa, in the event an emergency causes the Iowa Lottery to miss a reporting deadline, the multistate gaming product prize drawing could not be conducted, which could lead to potential litigation. Section 99G of the *Code* does not allow the Iowa Lottery's expenses to be paid from the State's General Fund and the Iowa Lottery deposits revenues quarterly to the State's General Fund. Therefore, in the event the previously deposited funds were needed due to an emergency, the Iowa Lottery would not be able to access the funds.

Although it is true the Iowa Lottery has the ability to sue and be sued, it was the State which was sued in the TouchPlay lawsuit, not the Iowa Lottery. Therefore, the State still has certain risks associated with potential lawsuits involving activities of the Iowa Lottery. In addition, the risks of the Iowa Lottery being sued do not appear significant enough to warrant becoming an Authority. When speaking to Iowa Lottery officials, we learned the Iowa Lottery has emergency backup data on hand to mitigate such risks with multistate gaming products. As such, this risk appears to be nominal.

Prior to becoming an Authority, the Iowa Lottery Act permitted the Iowa Lottery to retain funds sufficient to cover the foreseeable administrative expenses of the Iowa Lottery for a period of 21 days from moneys which would otherwise be transferred to the State. In addition, if the

amount of retainage was insufficient to mitigate risks, the Iowa Lottery could request additional protection through revision of current retainage limitations. Regardless, as an Authority, the Iowa Lottery now has additional control over funds in the event of an emergency.

To determine the impact of the Iowa Lottery's increased ability to make faster adjustments to its business operations as Iowa Lottery officials stated were among the benefits of becoming an Authority, we compared the Iowa Lottery's performance to state lotteries which operated as state agencies during the review period. **Table 3** compares increases in sales and transfers (in millions) to the State by the Iowa Lottery to increases in sales and transfers to a selection of state lotteries which function as state agencies.

**Table 3**

State	Sales			Transfers to State		
	2003*	2009*	Increase	2003*	2009*	Increase
Iowa	\$ 180.1	243.4	35.1%	\$ 39.0	60.6	35.6%
Kansas	202.9	232.5	13.8%	62.5	68.2	8.4%
Maryland	1,323.0	1,698.0	28.3%	445.0	493.2	9.8%
Missouri	708.6	969.0	36.8%	203.5	256.2	20.6%
Nebraska	80.92	123.3	52.4%	20.2	30.2	33.0%
South Carolina	726.9	1,008.5	38.7%	220.1	261.5	15.8%

\* - In millions

As demonstrated by the **Table**, state lotteries functioning as state agencies were also successful in increasing revenues between fiscal year 2003 and fiscal year 2009. The Iowa Lottery's sales increase from its pre-Authority level to its post-Authority level is similar to lotteries which maintained their state agency status during the review period. Therefore, it does not appear the Iowa Lottery's status as an Authority resulted in significantly greater sales growth than lotteries operating as state agencies.

When comparing transfers to the State from fiscal year 2003 to fiscal year 2009, the Iowa Lottery increased its transfers to the State at a rate consistent with its sales increase. The other state lotteries included in the comparison did not realize increases in transfers to the State at the same percentage as sales increased. However, there are several possible reasons for this, as discussed in the following paragraphs.

**Table 4** summarizes the transfers to the respective states as a percentage of sales for each state included in **Table 3**. In addition, it summarizes prize expense as a percentage of sales for each state during fiscal years 2003 and 2009.

**Table 4**

State	Transfers to State as Percent of Sales			Prizes Distributed as Percent of Sales		
	2003	2009	Change	2003	2009	Change
Iowa	21.7%	24.9%	3.2%	57.9%	56.9%	(1.0%)
Kansas	30.8%	29.6%	(1.2%)	52.8%	56.4%	3.6%
Maryland	33.6%	29.0%	(4.6%)	*	60.3%	*
Missouri	28.7%	26.5%	(2.2%)	61.3%	64.9%	3.6%
Nebraska	25.0%	24.5%	(0.5%)	53.1%	58.3%	5.2%
South Carolina	30.4%	26.0%	(4.4%)	57.2%	62.8%	5.6%

\* - Information unavailable for prize expense in fiscal year 2003.

Based on the **Table**, the Iowa Lottery was the only lottery in the selection of state lotteries which increased its transfers to the State as a percent of sales. However, the Iowa Lottery's fiscal year 2003 transfer to the State was lower than all other state lotteries included in the **Table**. Therefore, the increase resulted in making the Iowa Lottery's transfers to the State more consistent with other state lottery transfers, but did not result in the Iowa Lottery's performance exceeding that of other state lotteries which function as state agencies.

In addition, prize distribution percentages can impact transfers to the State since they are the largest cost of operating state lotteries. For the selected state lotteries included in the **Table**, the Iowa Lottery was the only state lottery which realized decreased prize distributions in fiscal year 2009. In addition, the Iowa Lottery's prize distributions as a percent of sales were significantly lower than several of the other state lotteries during the years included in the **Table**. While it is typical for prize distributions to vary slightly from year to year, the prize distributions affect each state's ability to transfer funds to the State.

#### Summary –

After discussions with Iowa Lottery officials, review of documentation and analysis of Iowa Lottery revenues and transfers to the State in comparison to states still operating as state agencies, evidence provided was not sufficient to conclude being an Authority was the reason the Iowa Lottery has increased revenues and transfers to the State since fiscal year 2003. State agencies have the ability to:

- Utilize bonds issued to procure real property after Legislative enactment,
- Adjust budgets mid-year to allow for alternate expenditures, and
- Enter into contracts, such as the contract with Casey's General Stores®.

Authority status has likely increased the speed at which the Iowa Lottery has been able to conduct certain activities, such as procuring the headquarters building and implementing and marketing new products or entering into contracts with new retailers. However, as a state agency, the Iowa Lottery also had the ability to procure real property, market new products and add new retailers. Additional approvals may be necessary for certain actions and certain limitations may have slowed the process of such activities if the Iowa Lottery had remained a state agency, but such activities were permissible for the Iowa Lottery as a state agency.

If certain approval processes required by the Legislature are negatively impacting agency operations and effectiveness, rules subjecting state agencies to certain approval processes should be evaluated to determine whether they are necessary to maintain adequate oversight while still allowing state agencies to conduct business effectively. If legislative oversight activities currently conducted are determined to be pertinent to protect the interest of taxpayers, those same activities should be applied to Authorities as well.

Based on our review of the selected state lotteries summarized in **Table 3** and **Table 4**, the Iowa Lottery's performance since it became an Authority has not outpaced the performance of state lotteries which did not become Authorities. Sales did not grow at a higher rate since fiscal year 2003 and transfers to the State as a percent of sales are not greater than lotteries operating as state agencies. The increase in transfers to the State shown in **Table 3** only brought the Iowa Lottery's transfers to the State up to a percentage more consistent with other state lotteries.

#### **Trends in Salaries Since Becoming an Authority**

As previously stated, Iowa Lottery officials stated the Iowa Lottery gained sole control over its budget and moved more quickly to introduce new lottery gaming products when it became an Authority. In addition, when the Iowa Lottery became an Authority, its CEO gained responsibility for setting the salaries of Iowa Lottery key personnel, with Iowa Lottery Board approval. The salary of the CEO is set by the Governor of Iowa.

With its ability to establish key personnel salaries, the Iowa Lottery significantly increased the salaries of key personnel and upgraded positions in a relatively short time. This resulted in substantially higher salaries for personnel serving in the same positions. Iowa Lottery representatives explained higher salaries were necessary to be competitive and retain key personnel. Since becoming an Authority in fiscal year 2004, approximately 77% of the employees leaving employment at the Iowa Lottery retired or left for health reasons. None of the remaining employees left for employment opportunities with other lotteries. Of the 7 key personnel who left the Iowa Lottery during this period, 4 retired. In addition, there has been minimal turnover at the Iowa Lottery in positions which were not classified as key personnel positions.

The support provided by Iowa Lottery officials was not sufficient to demonstrate attrition was an issue prior to the Iowa Lottery becoming an Authority. Iowa Lottery officials named only 3 specific employees who left the Iowa Lottery for other positions in the lottery industry in the 11-year period from 1988 to 1999 and stated other lotteries have made recruitment attempts on current Vice Presidents. However, losing 3 employees to other state lotteries in an 11-year period is not a sufficient risk to warrant the significant salary increases for all key personnel at the Iowa Lottery.

In addition to our conclusion the Iowa Lottery did not demonstrate it needed salary increases to retain key personnel, we question why the Iowa Lottery was permitted to increase salaries to retain key personnel when state agencies were restricted to the State's pay plan limitations. All state agencies would be more likely to retain key personnel if they were allowed to increase their salaries. Key personnel at the Iowa Lottery should not receive higher salaries than key personnel at other state agencies for retention purposes if not necessary at other state agencies. There is no support to show it is more important to retain staff at the Iowa Lottery than at other state agencies.

### **Compensation Review**

The Iowa Lottery became an Authority on September 1, 2003. By March 2004, the Iowa Lottery received the results of a completed compensation review which was requested by the Iowa Lottery to determine market salary levels for certain key personnel positions at the Iowa Lottery. The compensation review did not address employee benefits or cost of living when comparing the Iowa Lottery to other entities.

According to Iowa Lottery officials, the results of the compensation review were the basis for key personnel job classifications and salary ranges implemented in fiscal year 2005. **Appendix A** includes an excerpt from the compensation review which summarizes its recommendations. The compensation review was comprised of data obtained from a combination of information gathered from the following sources:

- Compensation Data 2003 Iowa/Nebraska survey of 185 private sector companies in the Central Region, which includes Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin, Nebraska and Iowa with company sizes of 101 to 200 employees,
- Salary.com job searches for data on education, government or nonprofit organizations in Des Moines with 101 to 200 employees and
- A selection of 7 other state lotteries which function independently from their respective state governments.

According to the compensation review, the consultant initially planned to include state government salary data in the review. However, the compensation review stated "it was determined the use of state government salary data would not be valid for this particular survey and was replaced by an additional published survey source." The consultant who performed the compensation review stated the prior Iowa Lottery CEO directed her to exclude state lotteries operating through the state and only include "independent" state lotteries in the compensation review. The consultant stated the prior Iowa Lottery CEO insisted the state lotteries which operated "independently" were the Iowa Lottery's peers and other state lotteries were not comparable due to their structure as state agencies. As a result, the Iowa Lottery was not

compared to state lotteries operating as state agencies or other comparable positions within the State. Instead of using salary data for other State entities or the lotteries functioning as state agencies, the compensation review utilized published survey data representing a combination of for-profit and not-for-profit organizations. Differences between the state lotteries included in the compensation review which could impact the Iowa Lottery, such as cost of living and profitability of the State lottery, were not adequately addressed in the compensation review.

**Table 5** compares the Iowa Lottery to 6 of the 7 other state lotteries included in the compensation review based on amounts summarized in the review for fiscal year 2002. The 7<sup>th</sup> state lottery invited to participate in the compensation review, Tennessee, elected not to participate and, therefore, is not included in the **Table**.

**Table 5**

<b>State</b>	<b>Population<sup>^</sup></b>	<b>Sales<sup>^</sup></b>	<b>Sales per Capita</b>	<b>Profits<sup>^</sup></b>	<b>Profits per Capita</b>
Georgia	8.2	\$ 2,449.36	\$ 299.07	\$ 726.00	\$ 88.64
Connecticut	3.4	907.90	266.25	272.38	79.87
Kentucky	4.0	638.72	158.10	174.97	43.30
South Carolina	4.0	319.99	79.99	87.72	21.93
Louisiana	4.5	311.62	69.71	112.49	25.16
Iowa	2.9	181.22	61.84	48.11	16.41
New Mexico	1.8	133.97	73.60	29.60	16.26

<sup>^</sup> - In millions

As demonstrated by the **Table**, the Iowa Lottery's population base, sales volume and profits were significantly smaller than most of the other state lotteries included in the compensation review. New Mexico was the only other state lottery in the compensation review with a smaller population and lower profits per capita than Iowa. In addition, Georgia and Connecticut realized profits per capita more than 4 times greater than Iowa.

Because the Iowa Lottery is significantly smaller than most of the other state lotteries included in the compensation review, using the salary data of the state lotteries with significantly larger operations does not appear appropriate. Therefore, the Iowa Lottery key personnel should not be eligible for salary increases based, in part, on the compensation data related to state lotteries 4 times larger than the Iowa Lottery.

In addition, according to an article in the Arkansas Democrat-Gazette on June 18, 2009, all 7 of the State lotteries included in **Table 5** were in the top 11 of 44 states' Lottery Director salaries. Therefore, as of June 2009, 75% of state lottery Directors in the country made less than the state lottery Directors of the states which were included in the compensation review. Including the state lotteries with the highest salaries virtually guaranteed the results of the compensation review would support increases to Iowa Lottery salaries.

The compensation review provided by the Iowa Lottery included an overview stating information from other state lotteries was the most relevant comparison to utilize. In addition, in a memorandum the prior Iowa Lottery CEO sent to Iowa Lottery Board members regarding the compensation review, the prior Iowa Lottery CEO stated, "Although lower averages generally prevailed for the lottery specific jobs in other states compared to comparable local private sector positions, the consultant chose to recommend salary ranges based on the lottery specific data (emphasis added)." However, the market salary calculation for the compensation review put the most weight on the Compensation Data and the Salary.com data, not state lottery data. In most cases, the Compensation Data and Salary.com salaries were higher than those of the other state

lotteries included in the compensation review. According to the consultant, emphasis on the state lottery data was used when developing the final recommended salary ranges. The consultant used professional judgment to draw the recommended conclusions.

To demonstrate the methodology of collecting data to use in developing the recommended salary ranges, **Table 6** summarizes the factors and the consultant's calculation of the total weighted average market salary for a Vice President of Marketing. **Table 6** also demonstrates how the compensation review gave the state lottery data a weight of 2 and the Compensation Data a weight of 53 to calculate a weighted average subtotal. The weighted average subtotal was then combined with the Salary.com data and divided by 2 to calculate the consultant's calculated market salary.

**Table 6**

Survey Source	Salary	Weight	Average Salary	Extended
State Lottery Surveys				
Kentucky	\$ 97,200.00			
Louisiana	81,120.00	2	\$ 89,160.00	\$ 178,320.00
Compensation Data		53	134,465.00	7,126,645.00
Total Salaries for 55 positions		55		\$ 7,304,965.00
Weighted Average Subtotal		1	132,818.00	
Plus: Salary.com salary*		1	101,329.00	
Total salaries for 2 positions		2	234,147.00	
Consultant's Calculated Market Salary			\$ 117,073.00	

\* - Salary.com did not indicate the number of salaries included in the average. The consultant averaged it with the weighted average of state salaries and compensation data collected, resulting in basing 50% of the average salary on the Salary.com salary.

As demonstrated by the **Table**, the primary components of the calculated salary were the Salary.com average salary and the 53 salaries recorded in the Compensation Data. Other state lotteries represented approximately 2.5% of the salaries included in the consultant's calculated market salary. According to the consultant, the larger weight for the Compensation Data was appropriate because the Compensation Data represented a larger number of salaries. In addition, according to the compensation review, the consultant did not include the Salary.com data in the initial weighted average because the number of salaries represented was unknown. However, by averaging the Salary.com data with the combined average salary of the Compensation Data and state lottery data, the consultant effectively gave 50% of the final weighted average to each of the two non-Lottery components, essentially ignoring the lottery specific data.

The state lottery average salaries were \$89,160.00, which was comparable to the salary of the Iowa Lottery's Vice President of Marketing, which was \$89,274.00 according to the compensation review. The 2 states included in the compensation review, Kentucky and Louisiana, have larger state populations, larger sales volume and larger per capita sales than Iowa. Performance and responsibilities were not equal between the 3 states and using salaries of state lotteries with substantially larger operations as benchmarks for comparison to the Iowa Lottery was not reasonable. **Table 7** summarizes the comparison of the 3 states as reported in the consulting firm's compensation review using sales amounts from 2002.

**Table 7**

State	Population*	Per Capita Sales
Kentucky	4.04	\$158.10
Louisiana	4.47	69.71
Iowa	2.93	61.84

\* - In millions



The states included in the **Table**, however, represented only approximately 2.5% of the weighted average calculation of the market salary for a Vice President of Marketing. In addition, the State lotteries included were conducting significantly more business or distributed tickets to larger population bases than the Iowa Lottery. Therefore, even if the state salary data had been given a heavier weight in the consultant's calculated salary in the compensation review, the salaries, given the differences in lottery activities, were not comparable.

By emphasizing the Compensation Data and Salary.com data, the calculated average for a Vice President of Marketing was \$117,073.00. While the compensation review also reported other lottery salaries and made other comparisons, the consulting firm recommended a Vice President of Marketing salary range from \$78,080.00 to \$106,080.00, with a midpoint salary of \$97,600.00. In fiscal year 2003, prior to becoming an Authority, the annualized salary of the Vice President of Marketing was \$83,804.00 according to payroll data reviewed. As previously demonstrated, this was already comparable to the average salary of the Vice President of Marketing for the other state lotteries included in the compensation review. However, by fiscal year 2006, the Vice President of Marketing was paid \$99,646.35, an increase of 18.9% from fiscal year 2003.

As a result of the compensation review, the consulting firm recommended increasing the maximum salary for each key personnel position. According to the consultant, the focus of the compensation review recommendation was the midpoint salary, not the maximum. Using judgment with consideration to internal and external factors, the consultant believed the current salaries were too low, but felt the calculated market salaries were too high and needed to be discounted to an extent. As a result, the consultant developed a blended average midpoint salary. In addition, the consultant recommended increasing the range of salaries for each key position, which resulted in the maximum salary recommendation being significantly higher than the Iowa Lottery salaries prior to the review.

While the CEO was included in the consultant's compensation review, the CEO's salary is established by the Governor. Prior to the Iowa Lottery becoming an Authority, the Lottery Commissioner's salary was set by the Governor within a range established by the Legislature, which also covered various Department Directors. When the Iowa Lottery became an Authority, the Legislature no longer established a salary range for the Lottery CEO and there were no limits on the salary the Governor could establish for the Lottery CEO.

The legislatively established maximum annual salary for the Lottery Commissioner at the time the Lottery became an Authority was \$126,175.00, and the Lottery Commissioner, who became the Iowa Lottery CEO, was paid \$125,836.38 for fiscal year 2004. While the consultant's compensation review recommended a salary of no less than \$164,119.00 and did not include a range, the Governor awarded a 64.5% salary increase to the Iowa Lottery CEO for fiscal year 2005, during which he was paid \$207,001.60. He then received annual salary increases ranging from 3.8% to 7.1% until his retirement in fiscal year 2008, when his annual salary was \$239,777.46, a 90% increase over the 4 years since fiscal year 2004.

According to the consultant, the purpose of recommending larger salary ranges with higher maximum salaries was to give the Iowa Lottery the ability to gradually adjust salaries while staying in the recommended salary ranges. However, after receipt of the recommendations, the prior Iowa Lottery CEO recommended and the Iowa Lottery Board approved increasing non-CEO key personnel salaries to the maximum salary amount for each position. Iowa Lottery Board meeting minutes did not provide details which document why the Iowa Lottery Board approved the aggressive salary adjustments. **Table 8** summarizes the results of the compensation review and subsequent changes to the salary maximums for the non-CEO key personnel at the Iowa Lottery.

**Table 8**

<b>Position</b>	<b>Fiscal Year 2004 Salary Maximum</b>	<b>Compensation Review Salary Maximum</b>	<b>Maximum Salary~</b>	<b>Fiscal Year 2010 Salary Maximum**</b>
Vice Presidents:				
Chief Operating Officer	\$ 102,003.20	129,540.00	129,540.00	143,686.40
External Relations^	77,729.60	90,120.00	106,080.00	117,665.60
Finance	88,649.60	117,120.00	117,120.00	129,916.80
Marketing	92,976.00	106,080.00	106,080.00	117,665.60
Sales	88,649.60	106,080.00	106,080.00	117,665.60
Security	88,649.60	106,080.00	106,080.00	117,665.60
Assistant VP, Legal Affairs^^	67,516.80	78,120.00	78,120.00	86,652.80

~ - Approved on June 18, 2004 and implemented over a 2-year period beginning in fiscal year 2005.

^ - The CEO recommended a higher salary consistent with the other Vice Presidents based on his assessment of the duties of the position and the Board agreed with the CEO's recommendation.

^^ - Compensation review title was Organization Development Manager. In fiscal year 2011, the Iowa Lottery upgraded the position to VP of General Counsel, with a salary maximum consistent with several other VPs.

\*\* - Per Iowa Lottery personnel, the salary maximums have been increased by the cost-of-living adjustments (COLAs) received by other State employees since fiscal year 2005.

Based on the details included in the compensation review, it is unclear how the recommendations included in **Table 8** were derived by the consultant. For example, the consultant's calculated market salary included in the compensation review for the Vice President of Marketing, as shown in **Table 6**, was \$117,073.00. However, the compensation review recommended a salary range for the Vice President of Marketing of \$70,720.00 to \$106,080.00. As previously discussed, the consultant explained the recommendations were based on the blended average midpoint salary. The Iowa Lottery implemented the recommended salary ranges for each of the key personnel positions included in the compensation study, except for the Vice President of External Relations. However, when the prior Iowa Lottery CEO presented the compensation review recommendations to the Iowa Lottery Board, he stated the Vice President of External Relations has equal responsibilities and skill set requirements to most of the other Vice Presidents at the Iowa Lottery and, therefore, should receive the same salary. The Iowa Lottery Board approved the increase.

According to Iowa Lottery Board meeting minutes for June 18, 2004, after initial raises for fiscal year 2005 when the new pay ranges were approved, the Iowa Lottery Board approved raising 5 of the 6 Vice President's salaries to the maximum amount of their newly approved pay ranges for fiscal year 2006. Payroll records confirm these raises were implemented. The Iowa Lottery Board minutes did not include pre-set salary increases for fiscal year 2006 for 1 vice president and 1 assistant vice president. **Appendix B** contains an excerpt from the June 18, 2004 Iowa Lottery Board meeting minutes approving this action. When we told the consultant the Iowa Lottery had approved increasing the key personnel salaries to the maximum in a 2-year time frame, the consultant stated she never would have recommended such a decision and emphasized it is not a good practice to do so.

The consultant stated the purpose of implementing a larger salary range with a higher ceiling was not to recommend across-the-board salary increases to the maximum. Rather, it was to make room for gradual increases to salaries subject to performance or longevity. In addition, according to the compensation review, the midpoint salary is considered to be an approximate 5-year rate, meaning the midpoint salary is the rate the employer could use as a guide for the salary of an employee being in the position 5 years. By incorporating the ranges, the consultant's goal was to allow the Iowa Lottery room to increase salaries "in stages versus a dramatic increase," according to the compensation review. The consultant stated incorporating the salary range maximum across-the-board was not a good business practice because it eliminated the Iowa Lottery's ability to adjust salaries to reward high performance or longevity.

As demonstrated by the preceding discussion, the Iowa Lottery Board inappropriately delegated the compensation review to Lottery management who would be financially impacted by the results of the review. This delegation created several issues with critical parameters of the compensation review, including:

- improper compensation comparables were dictated by Lottery management,
- the impact of employee benefits was ignored and
- the impact of cost of living was ignored.

Since the parameters of the compensation review were not appropriately established, the results of the compensation review are seriously flawed. In addition, a reading of the compensation review report by Iowa Lottery Board members should have raised significant concerns regarding the compensation comparables utilized, the weighting assigned to the comparables and the conflicting communication from the prior Iowa Lottery CEO. Furthermore, the Iowa Lottery Board had no direct interaction with the consultant who performed the compensation review, which contributed to the improper application of the results of the compensation review. By inappropriately delegating the compensation review, the Iowa Lottery Board appears to have failed to properly exercise its fiduciary responsibilities in determining and approving appropriate key personnel salaries.

#### Summary -

After evaluation of the compensation review's methodology, comparison data and recommendations, we concluded the compensation review was flawed in its entirety due to the parameters set by the prior Iowa Lottery CEO and should not have been the basis of salary adjustments at the Iowa Lottery. In addition, the Iowa Lottery misused the recommended salary ranges to obtain Iowa Lottery Board approval of large salary increases over a 2-year period, which brought several key personnel salaries to the maximum. Iowa Lottery key personnel should not have been eligible to receive significantly higher salaries than key personnel at other State entities who also provide valuable services for the State. The reasons for this conclusion include the following:

- Salary.com data was too heavily weighted in calculating the consultant's calculated market salary and data was not sufficient to determine whether the responsibilities of the employees included in the compensation review were comparable to the key personnel at the Iowa Lottery. The consultant we spoke with was unable to provide details on the specific entities included in the Salary.com data. However, the consultant's use of the Salary.com data was driven by the Iowa Lottery CEO's instructions to include only certain state lotteries.
- Compensation Data was too heavily weighted in calculating the consultant's calculated market salary and included private sector, for profit entities. The consultant we spoke with was unable to provide details on the specific entities included in the Compensation Data. As a result, we are unable to determine whether the responsibilities of the employees included in the compensation review were comparable to the key personnel at the Iowa Lottery. As with the Salary.com data, the consultant included the Compensation Data after the Iowa Lottery CEO directed the consultant to limit state lottery salary in the compensation review to those state lotteries he determined to be the Iowa Lottery's peer group.

According to Iowa Lottery officials, the Iowa Lottery has entrepreneurial traits which make it independent of the State. However, the Iowa Lottery is still an entity of the State and officials did not provide specific information to demonstrate an entrepreneurial entity would be unable to function by utilizing the State's pay structure. A majority of the Iowa Lottery's non-key personnel are compensated through the State's pay structure. Many of these positions are covered by a union contract. As a result, the positions fall under the State's pay structure. It is unclear why the State's pay structure does not work for the non-contract key personnel and why they should be treated differently from other non-contract employees at other State entities.

- Some of the state lotteries selected for inclusion in the compensation review were not comparable to the Iowa Lottery based on their size and output. The state lotteries selected for inclusion in the compensation review were among the state lotteries with the highest paid CEO's/Directors in the nation, based on an article published in 2009. By including some of the highest paying state lotteries in the review, it virtually guaranteed the compensation review would recommend salary increases for Iowa Lottery key personnel positions.
- The prior Iowa Lottery CEO selected the state lotteries to include in the compensation review and inappropriately directed the consultant to exclude salary data for state lotteries operating as state agencies from the compensation review. The change from state agency to Authority did not increase responsibilities to the extent the other lotteries would not be comparable. Further, state lotteries operating as state agencies are significantly more relevant to the Iowa Lottery in terms of business model than the private sector and university entities which were included in the Compensation Data and Salary.com survey results.
- The calculation of the consultant's market salary calculation relied heavily on survey data and only minimally on state lottery data, even though the consultant stated state lottery salary data was the most relevant comparison. According to the consultant, emphasis on state lottery data was used when developing the final recommended salary ranges. The consultant used professional judgment to draw the recommended conclusions.
- Output, state size, geographic cost of living variances, employee benefits and other factors were not adequately addressed in the compensation review.
- We were unable to reach the consultant's conclusion of recommended salary ranges based on the information included in the compensation review. According to the consultant, the amounts recommended were blended average rates based on judgmental factors and were based primarily on bringing the midpoint salary to a level equal to the market. However, without additional information to support the calculation of recommended salaries, we were unable to validate the recommended salaries.
- The compensation review recommended a salary of at least \$164,119.00 for the prior Iowa Lottery CEO. However, Governor Vilsack and Governor Culver approved significantly higher increases. The prior Iowa Lottery CEO's salary nearly doubled from fiscal year 2003 to fiscal year 2008, when the prior Iowa Lottery CEO's salary rose to \$239,777.46. As previously stated, when the prior Iowa Lottery CEO retired in fiscal year 2008, he began receiving significantly higher IPERS benefits for the duration of his life because of the salary increases he received when the Iowa Lottery became an Authority. According to IPERS, the prior Iowa Lottery CEO's IPERS benefits are nearly 60% higher than the IPERS benefits he would have received had the Iowa Lottery remained a state agency.
- The compensation review did not provide adequate support to conclude employees of the Iowa Lottery are entitled to more compensation than other state employees holding positions of similar responsibility. In addition, other State entities could probably conduct similar compensation reviews of their key personnel using non-State salary comparisons and receive similar results.
- The Iowa Lottery used the compensation review to justify dramatic salary increases for key personnel across-the-board. However, the Iowa Lottery misused the results of the compensation review, which specifically stated the common and acceptable practice of increasing salaries was to increase them "in stages versus a dramatic increase." In addition, the consultant stated increasing the salaries across-the-board eliminated the value of instituting the salary ranges because it removed the Iowa Lottery's ability to compensate employees based on performance or longevity.

As a result of the compensation review and Iowa Lottery Board approval of increased salaries as proposed by the prior Iowa Lottery CEO, key personnel received significant salary increases in the first 3 years after becoming an Authority. In addition, Governor Vilsack nearly doubled the prior Iowa Lottery CEO's salary over a 3-year period. The Iowa Lottery used the compensation review as

an inappropriate basis for salary increases. The prior Iowa Lottery CEO dictated the parameters of the comparison data used in the compensation review and the Iowa Lottery Board did not intervene to ensure the compensation review was objective, which resulted in unjustified salary increases for key personnel at the Iowa Lottery. The compensation review did not provide independent and relevant comparison data to support the higher salaries of Iowa Lottery key personnel. The Iowa Lottery did not use the recommended salary ranges as designed because across-the-board salary increases to the maximum salary were not recommended.

### **Key Personnel**

Prior to becoming an Authority, the Iowa Lottery's key personnel were compensated based on the State's approved pay plan. In fiscal year 2003, key personnel were classified as public service executives or executive officers, with the exception of the Executive Secretary. However, when the Iowa Lottery became an Authority, it created Lottery specific job classifications and increased the maximum salary amounts key personnel were eligible to receive based on the compensation review completed.

In fiscal year 2005, the Iowa Lottery reclassified its key personnel under a new salary structure specific to the Iowa Lottery. The positions created and designated as key personnel as a result of the new salary structure are as follows:

- Lottery Chief Executive Officer
- Lottery Vice President, Chief Operating Officer
- Lottery Vice President, External Relations
- Lottery Vice President, Finance
- Lottery Vice President, Marketing
- Lottery Vice President, Sales
- Lottery Vice President, Security
- Lottery Assistant Vice President, Legal Affairs, which was upgraded to Lottery Vice President, General Counsel in September 2010
- Lottery Executive Secretary

All other Iowa Lottery personnel are still compensated in accordance with the State's pay plan utilized for other State personnel.

In addition to creating the key positions of CEO and the 6 Vice President positions listed above as a result of the compensation review, the Iowa Lottery made the following adjustments to the positions designated as "key personnel."

Public Affairs Manager - In fiscal year 2006, the Iowa Lottery created a new key personnel position, a Public Affairs Manager. The Public Affairs Manager position was created to assume certain duties previously performed by the Vice President of External Relations. According to documentation we reviewed, the Public Affairs Manager position and the Vice President of External Relations "worked in tandem". Many of the primary duties of the positions overlapped, which resulted in 2 key positions with similar responsibilities.

When the person hired as Public Affairs Manager left the Iowa Lottery in fiscal year 2009, the Iowa Lottery removed the position from its list of key personnel positions and the duties performed by the former Public Affairs Manager were absorbed into other positions, according to a representative of the Iowa Lottery we spoke with. The Iowa Lottery representative stated the position was determined to be a key position when the Touchplay game was in operation. However, Touchplay ended in fiscal year 2006 and the Public Affairs Manager remained at the

Iowa Lottery until fiscal year 2009. The position was inactivated by the Iowa Lottery in September 2011, having remained unfilled for 2 years.

Vice President of General Counsel - In fiscal year 2011, the Iowa Lottery upgraded the position of Assistant Vice President of Legal Affairs to Vice President of General Counsel. According to the compensation review conducted when the position was created, the position warranted a lower salary than other key personnel positions. However, according to the Iowa Lottery Board meeting minutes for September 2, 2010, the initial position description was no longer representative of the job skills needed for the position. Therefore, the Iowa Lottery rewrote the position description to upgrade the responsibilities of the individual currently in the position. In addition to increasing the position requirements from part time to full time, the Iowa Lottery also upgraded the position.

**Table 9** demonstrates how the salary of the Vice President of General Counsel compares to salary maximums of comparable positions under the State's pay plan for fiscal year 2012. In addition, the **Table** includes the current salary maximum for the Iowa Finance Authority General Counsel, which is the position the Iowa Lottery used as a model for developing the new position description.

<b>Table 9</b>	
<b>Position</b>	<b>Maximum Salary</b>
Executive Officer 2	\$ 79,456.00
Attorney 2	85,696.00
Assistant Attorney General 2	87,235.20
Attorney 3	104,332.80
Assistant Attorney General 3	109,408.00
Lottery Vice President of General Counsel	120,016.00
Finance Authority General Counsel	120,078.00

Prior to becoming an Authority, the position of Assistant Vice President of Legal Affairs was compensated as an Executive Officer 2 under the State's pay plan. In fiscal year 2012, the Executive Officer 2 maximum salary is \$79,456.00. When the position was evaluated during the compensation review, the consultant compared the position, which was named the Assistant Vice President of Legal Affairs, to private sector positions of Staff Attorney or Attorney II and the Iowa Lottery accepted the consultant's recommended salary range for the position. The maximum salary of an Attorney 2 under the State's pay plan in fiscal year 2012 is \$85,696.00. If the Iowa Lottery had followed the State's pay plan and increased the position from an Attorney 2 to an Attorney 3 position when the responsibilities of the position changed, the pay plan maximum for fiscal year 2012 would have been \$104,332.80. According to the State's pay plan, an Attorney 3 serves as an agency's chief/general counsel and oversees all legal questions, problems and issues confronting the department or independent operating agency. This definition appears appropriate for the head legal advisor for the Iowa Lottery. We also included salary information for positions at the Attorney General's Office, which we believe would be comparable to an in-house general counsel position for an agency comparable to the Iowa Lottery.

Iowa Lottery officials stated they used the position of Iowa Finance Authority General Counsel as a basis for developing a new position description for the new key personnel position. The Iowa Lottery Board approved upgrading the position description and compensation and renamed the position the Vice President of General Counsel. Based on the fiscal year 2012 pay plan, the maximum salary for the position is \$120,016.00, which is consistent with the salary maximum for several other Iowa Lottery Vice Presidents. It is also consistent with the Iowa Finance Authority General Counsel's maximum salary, which is \$120,078.00 in fiscal year 2012.

In fiscal year 2012, the maximum salary the Vice President of General Counsel is eligible to receive, \$120,016.00, is over 50% higher than the salary the position would have been eligible to receive prior to becoming an Authority. In addition, it is 15% higher than the maximum salary for an Attorney 3 position under the State's pay plan. We do not believe the duties of the Vice President of General Counsel warrant a salary higher than that of an Attorney 3. As of July 2011, the salary of the Vice President of General Counsel was \$91,811.20.

Executive Secretary - The Executive Secretary key personnel position has also evolved since it was first established. Prior to the Iowa Lottery becoming an Authority, the Executive Secretary function was a Secretary III under the State's pay plan. However, the Iowa Lottery changed the position to an Executive Secretary position in fiscal year 2005, significantly increasing the maximum salary. After the Executive Secretary who first held the position retired in fiscal year 2009, the Iowa Lottery did not refill the position. Instead, Iowa Lottery officials reduced the salary maximum for the position. According to Iowa Lottery Board meeting minutes, the Iowa Lottery reduced the salary range of the key personnel position back to the Secretary III level "based on current duties." Based on documentation provided by the Iowa Lottery, the duties of the position were not reduced when the salary adjustment was made. Then in September 2010, the Iowa Lottery decided to restore the higher salary maximum. According to the Iowa Lottery Board meeting minutes, the Iowa Lottery decided not to fill 2 of its vacant secretarial positions but added new duties to enhance the Executive Secretary position and added project management and coordination duties in addition to the duties of the Board secretary.

#### Summary -

All 3 positions which have evolved, the Vice President of General Counsel, the Public Affairs Manager and the Executive Secretary, appear to have been created specifically for an individual employee or to allow the Iowa Lottery to designate salary ranges outside the State's pay plan limitations rather than to meet a "key" need of the Iowa Lottery. This is a misuse of the Iowa Lottery's ability to create key positions. If the Iowa Lottery had still been a state agency, it would have been required to submit a request for an adjustment with adequate justification to demonstrate the duties of the position warranted the designated salary.

- It appears the Executive Secretary position was created to reward a valued employee. If the position was truly a "key" position, the Iowa Lottery would not have reduced the salary maximum on the employee's retirement without adjusting the position requirements at the same time. Had the position truly been "key," the salary range would have remained the same when the initial Executive Secretary retired and the next person hired for the position would have been hired at a lower salary within the previously established salary range. In addition, if it was necessary to increase the duties and responsibilities of the Executive Secretary position in order to justify restoring the higher salary maximum to the position, the initial justification for allowing the higher salary maximum salary was insufficient to justify the authorized salary maximum.
- The Iowa Lottery created a "key" personnel position and hired an individual as the Public Affairs Manager. Prior to the individual being hired, the position did not exist. Further, the position had similar duties to the Vice President of External Relations. Even though Lottery officials indicate certain challenges facing the Iowa Lottery warranted additional efforts in the area of external relations, it is unclear why it was necessary to designate 2 positions providing a similar function as "key." When the employee separated from the Iowa Lottery, the Iowa Lottery no longer needed the position and the duties of the position were absorbed by other personnel. Creating a key position to reward a specific individual or creating a special position and designating the approved salary of the position without the limitations of the State's pay plan is not an appropriate use of the Iowa Lottery's authority.
- The Iowa Lottery initially employed an Assistant Vice President of Legal Affairs. According to the compensation review conducted when the position was created, the position warranted a

lower salary than other key personnel. However, according to Iowa Lottery Board meeting minutes, when the Iowa Lottery found the Assistant Vice President of Legal Affairs' performance to be good, Iowa Lottery officials requested an adjustment to the duties of the position to full time with increased responsibilities and upgraded the position to Vice President of General Counsel. When this "key" position was created, it was considered comparable in the initial compensation review to private sector positions of Staff Attorney or Attorney 2. However, when the Iowa Lottery adjusted the position to a Vice President from the former Assistant Vice President designation, the Iowa Lottery bypassed the normal progression of position upgrades, resulting in a maximum salary of \$120,016.00 in fiscal year 2012 for the Vice President of General Counsel.

- If it is appropriate for the Iowa Lottery to upgrade positions to fit its personnel or to offer more attractive compensation packages than permitted through the State's pay plan, it should be appropriate for all state agencies to do so as well. State agencies also have invaluable personnel who have reached their maximum salary at certain positions and also encounter business challenges in which the ability to create a special position and set the position's salary would be beneficial to operations. However, state agencies do not have the ability to create new positions and designate the salaries of the new positions or to increase a position's responsibilities and maximum salary without obtaining approval from DAS. The Iowa Lottery is not required to obtain DAS approval for the key personnel positions and salary ranges it creates. As a result, Iowa Lottery employees receive more compensation than State personnel even though the Iowa Lottery has continued to operate in essentially the same manner as was done prior to becoming an Authority. Making the Iowa Lottery an Authority has given the Iowa Lottery flexibility to reward employees without providing the same flexibilities to other State agencies. As a result, there is an appearance Iowa Lottery employees are more valuable than other State employees.

Since becoming an Authority, the Iowa Lottery has used its ability to establish and adjust key personnel positions and salaries in order to promote and financially reward specific employees. The Iowa Lottery has the ability to create key personnel positions, and oversight over the reasonableness or necessity of those positions is not adequate. As demonstrated above, the Iowa Lottery has sometimes utilized its authority to create key personnel positions to fit its personnel, rather than identifying truly key positions and functions essential to the viability of the Iowa Lottery.

As previously stated, in addition to the Iowa Lottery rewarding specific employees through designating them as "key personnel," Governor Vilsack and Governor Culver approved significant salary increases for the prior Iowa Lottery CEO, who received significant financial compensation increases when the Iowa Lottery became an Authority. As demonstrated in the next section of this report, the prior Iowa Lottery CEO's salary increased over 75% in the 3 years following the Iowa Lottery becoming an Authority, which not only affected his salary, but also significantly impacted his IPERS retirement benefits. As previously stated, in fiscal year 2003, the prior Iowa Lottery CEO's salary was \$122,811.38. When the prior Iowa Lottery CEO retired in fiscal year 2008, he began receiving significantly higher IPERS benefits for the duration of his life because of the salary increases he received when the Iowa Lottery became an Authority. According to IPERS, the prior Iowa Lottery CEO's IPERS benefits are nearly 60% higher than the IPERS benefits he would have received had the Iowa Lottery remained a state agency.



## **Iowa Lottery Key Personnel Salary Adjustments**

**Table 10** summarizes base salaries at the Iowa Lottery from fiscal year 2003 through fiscal year 2006. The **Table** does not include other compensation, such as bonuses. Fiscal year 2003 was the final year before the Iowa Lottery became an Authority. The Iowa Lottery significantly increased key personnel salaries in the 3 years after becoming an Authority. Fiscal year 2005 and 2006 increases were approved based on the results of the compensation review previously discussed.

**Table 10**

Position	Fiscal Year				Total		Average Annual Increase
	2003	2004*	2005	2006	Increase	Percent	
Chief Executive Officer^	\$ 122,811.38	125,836.38	207,001.60	215,759.36	92,947.98	75.68%	25.23%
Vice Presidents:							
Chief Operating Officer	96,666.40	102,003.20	115,772.80	129,012.80	32,346.40	33.46%	11.15%
External Relations	72,036.80	77,292.80	86,590.40	95,130.40	23,093.60	32.06%	10.69%
Finance	83,999.20	88,649.60	102,876.80	116,576.80	32,577.60	38.78%	12.93%
Marketing~	83,804.00	90,412.80	95,416.00	99,646.35	15,842.35	18.90%	6.33%
Sales	74,278.40	80,352.00	94,744.00	105,644.00	31,365.60	42.23%	14.08%
Security	83,999.20	88,649.60	97,364.80	105,744.80	21,745.60	25.89%	8.63%
Assistant Vice President:							
Legal Affairs	47,902.40	52,312.00	57,283.20	67,138.50	19,236.10	40.16%	13.39%
Executive Secretary	39,794.40	41,995.20	47,569.60	52,929.60	13,135.20	33.00%	11.00%

\* - In fiscal year 2004, key personnel also received additional pay ranging from \$5,403.00 to \$9,400.00.

^ - The CEO salary is set each year by the Governor, not the Iowa Lottery Board.

~ - This position was already established as a Lottery specific position prior to 2003, so the average annual increase is not as significant.

As demonstrated by the **Table**, salaries of key personnel at the Iowa Lottery increased significantly as a result of the compensation review recommendations and the Iowa Lottery's ability to set its salaries because of its Authority status, with salary increases ranging from 18.90% to 75.68% from fiscal year 2003 through 2006, or an average of 6.33% to 25.23% over the 3-year period. In contrast, **Table 11** and **Table 12** summarize how salaries at other State entities changed from fiscal year 2003 through fiscal year 2006, based on annualized base salaries received for the last pay period of each fiscal year.

**Table 11** summarizes Executive Director salaries for a selection of State positions comparable to the Iowa Lottery CEO position.

**Table 11**

Entity# and Position	Fiscal Year				Total		Average Annual Increase
	2003	2004	2005	2006	Increase	Percent	
ABD Administrator	\$ 82,217.46	90,433.98	100,006.40	110,007.04	27,789.58	33.80%	11.27%
DOC Director	104,999.96	104,999.96	104,999.96	119,106.78	14,106.82	13.44%	4.48%
DED Executive Director	126,124.96	126,124.96	126,124.96	139,999.86	13,874.90	11.00%	3.67%
IFA Executive Director	103,123.80	105,781.00	105,781.00	111,069.92	7,946.12	7.71%	2.57%
IPTV Administrator	95,999.80	95,999.80	95,999.80	104,063.96	8,064.16	8.40%	2.80%
DHS Director	126,174.88	126,174.88	126,174.88	132,483.53	6,308.65	5.00%	1.67%
DPH Director	117,999.96	122,720.00	122,720.00	128,856.00	10,856.04	9.20%	3.07%
Revenue Director	126,174.88	126,174.88	126,174.88	130,000.00	3,825.12	3.03%	1.01%
DOT Director	126,172.80	126,172.80	126,172.80	128,232.00	2,059.20	1.63%	0.54%

# - **Appendix D** includes the full names and abbreviations of the entities.

**Table 12** summarizes division director salaries at a selection of State entities comparable to the Iowa Lottery's Vice Presidents. Many of the positions listed in **Table 12** are held by employees who supervise significantly larger staffs and administer considerably larger programs than those at the Iowa Lottery. These positions are comparable because they report directly to the individual responsible for the State entity's operations. For comparison purposes, the **Table** also includes the average salary of all executive branch employees, regardless of position title and job responsibilities.

**Table 12**

Entity# and Position	Fiscal Year				Total		Average Annual Increase
	2003	2004	2005	2006	Increase	Percent	
IPTV Director, Admin and Finance	\$ 86,902.40	88,649.60	92,227.20	94,536.00	7,633.60	8.79%	2.93%
DHS Deputy Director of Programs and Services	105,601.60	112,028.80	116,563.20	119,475.20	13,873.60	13.14%	4.38%
DHS Division Director, Division of Mental Health and Disability Services	100,006.40	102,003.20	106,121.60	108,784.00	8,777.60	8.78%	2.93%
DPH Division Director, Chronic Disease Prevention/Health^	86,902.40	88,649.60	104,436.80	108,784.00	21,881.60	25.18%	8.39%
DED Chief of Staff	100,006.40	102,003.20	106,121.60	108,784.00	8,777.60	8.78%	2.93%
DNR Deputy Director	102,814.40	110,115.20	116,563.20	119,475.20	16,660.80	16.21%	5.40%
Average of all Executive Branch Employees*	43,476.00	51,441.00	47,506.00	48,605.00	5,129.00	11.8%	3.93%

\* - From the Department of Administrative Services "Just the Facts" Iowa Executive Branch Workforce Almanac.

^ - In November 2004, this position was upgraded from a Public Service Executive 4 position to a Public Service Executive 5 position and in December 2004 there was an across-the-board pay increase of 2%. Excluding fiscal year 2005, the average increase per year was 3.09%.

# - **Appendix D** includes the full names and abbreviations of the entities.

By comparing the salaries at the Iowa Lottery and the salaries at other State entities as summarized in **Tables 10, 11** and **12**, we determined:

- In the 3-year period after the Iowa Lottery became an Authority and approved the new key personnel salaries, the prior Iowa Lottery's CEO earned a higher base salary than those in the highest position at all other State entities included in **Table 11**, including other Authorities and another revenue generating entity, ABD. As demonstrated later in this report, many of the other agencies in **Table 11** are significantly larger than the Iowa Lottery.
- For comparative purposes, the prior Iowa Lottery CEO's annualized base salary, excluding other pay, was \$122,811.38 in fiscal year 2003 and \$215,759.36 in fiscal year 2006, an increase of 75.68% over 3 years. During the same 3-year period, the highest increase of non-Lottery State entities in **Table 11** was another revenue-generating entity of the State, ABD. ABD increased its Executive Director's annualized base salary 33.8%.

Iowa Lottery officials stated Iowa Lottery salaries could not be compared to State entity salaries due to the Iowa Lottery's entrepreneurial business style. However, Iowa Lottery officials could not provide adequate justification for this position. We determined Iowa Lottery salaries for key personnel are also significantly higher than the salaries of comparable ABD employees, who are also employed by a State entity with an entrepreneurial business style. In addition, ABD transferred over \$10 million more to the State's General Fund than the Iowa Lottery in fiscal year 2005.

We do not believe State entities with the primary purpose of generating revenues for the State have more responsibilities or are more valued than State entities providing key services for citizens of the State. Therefore, there does not appear to be justification for a separate pay structure for key personnel positions at the Iowa Lottery.

- Average annual salary increases for key personnel in the 3-year period included in our testing ranged from 6.33% to 25.23% at the Iowa Lottery. In contrast, the Directors of other State entities included in the comparison received average annual salary increases in the 3-year period ranging from 0.54% to 11.27% and the Division Directors or similar positions received average annual salary increases of 2.93% to 8.39%. According the DAS' "Just the Facts" report, average Executive Branch employee salary increases in the 3-year period were 3.93%. As indicated by these averages, the Iowa Lottery's salary increases were not in line with other State entities, including other Authorities, another revenue generating State entity and a selection of larger state agencies.
- A majority of the State entity key personnel included in **Table 11** did not receive any salary increases in fiscal years 2004 and 2005 during a time Iowa Lottery salaries increased substantially. The Directors of some of the largest State entities, such as DOT and Public Health, did not receive salary increases in fiscal years 2004 and 2005. In contrast, Governor Vilsack approved a 68.55% salary increase for the prior Iowa Lottery CEO and the Iowa Lottery Board approved key personnel salary increases ranging from 13.86% to 27.55% during that period.
- The Iowa Lottery CEO has the authority, with Iowa Lottery Board approval, to establish the salary structure for key personnel. There are no restrictions on the amount and number of salary increases the CEO can grant, up to the maximum salary established for any key personnel position. In addition, the CEO has authority to increase the maximum salary range of key personnel positions, if approved by the Iowa Lottery Board. As a result, even though key personnel may reach their maximum salary, there is the potential for additional salary to be awarded at the discretion of the CEO and the Iowa Lottery Board. For employees of State entities under the State pay structure, once the maximum salary level is reached, there is no potential for additional salary increases unless the position is reclassified. The only increases available would be across-the-board adjustments authorized by the Legislature.

Since becoming an Authority, Iowa Lottery key personnel salaries have continued to rise. **Table 13** summarizes the increases in Iowa Lottery annualized base salaries from fiscal year 2003 to fiscal year 2009. **Table 13** only summarizes annualized base salaries and does not include other pay.

**Table 13**

Position	Fiscal Year 2003 Base Salary	Fiscal Year 2009~ Base Salary	Increase	Average Annual Increase
Chief Executive Officer*	\$ 122,811.38	167,893.96	36.71%	6.12%
VP, Chief Operating Officer	96,666.40	143,688.10	48.64%	8.11%
VP, External Relations	72,036.80	117,660.66	63.33%	10.56%
VP, Finance	83,999.20	118,663.22	41.27%	6.88%
VP, Marketing	83,804.00	117,665.60	40.41%	6.73%
VP, Sales	74,278.40	117,660.66	58.40%	9.73%
VP, Security^	83,999.20	104,649.74	24.58%	4.10%
Assistant VP, Legal Affairs^^	47,902.40	81,849.12	70.87%	11.81%
Executive Secretary	39,794.40	58,654.16	47.39%	7.90%

~ - We did not use fiscal year 2010 salary amounts due to mandatory furloughs which reduced salaries across the board.

\* - In fiscal year 2008, the CEO retired. The CEO's annualized salary in fiscal year 2008 prior to retirement was \$239,777.46, an increase of 95% from fiscal year 2003.

^ - In fiscal year 2009, the VP of Security retired and a new VP was hired. The VP of Security's annualized base salary in fiscal year 2008 was \$113,672.00, an increase of 34.94% from fiscal year 2003.

^^ - In fiscal year 2011, this position was upgraded to VP of General Counsel with the same pay range as the VPs of Marketing, External Relations, Security and Sales.

**Table 14** is a summary of how selected State entity officials' salaries have changed since fiscal year 2003 based on annualized base salaries for the positions listed based on the salary of the person in the position at the end of each fiscal year. **Table 14** summarizes base salaries only for executive level positions in other State entities. Therefore, the actual gross salaries of those included in the summary may be different.

<b>Table 14</b>				
<b>Entity# and Position</b>	<b>2003 Salary</b>	<b>2009 Salary</b>	<b>Increase</b>	<b>Average Annual Increase</b>
ABD Administrator	\$ 82,217.46	124,992.40	52.03%	8.67%
DOC Director	104,999.96	142,105.34	35.34%	5.89%
DED Executive Director	126,124.96	145,810.86	15.61%	2.60%
IFA Executive Director	103,123.80	128,886.94	24.98%	4.16%
IPTV Administrator	95,999.80	129,213.50	34.60%	5.77%
DHS Director	126,174.88	152,006.40	20.47%	3.41%
DPH Director	117,999.96	127,986.82	8.46%	1.41%
Revenue Director	126,174.88	148,525.78	17.71%	2.95%
DOT Director	126,172.80	147,908.80	17.23%	2.87%

# - **Appendix D** includes the full names and abbreviations of the entities.

**Table 15** summarizes how additional selected State entity officials' salaries have changed since fiscal year 2003 based on annualized base salaries for the person in the position at the end of each fiscal year for the positions listed. **Table 15** summarizes base salaries of Division Director positions which could be compared to the Iowa Lottery's Vice President positions.

<b>Table 15</b>				
<b>Entity# and Position</b>	<b>2003 Salary</b>	<b>2009 Salary</b>	<b>Increase</b>	<b>Average Annual Increase</b>
IPTV Director, Admin and Finance	\$ 86,902.40	102,294.40	17.71%	2.95%
DHS Deputy Director of Programs and Services	105,601.60	150,404.80	42.43%	7.07%
DHS Division Director of Mental Health and Disability Services	100,006.40	117,728.00	17.72%	2.95%
DPH Division Director of Chronic Disease Prevention/Health	86,902.40	117,728.00	35.47%	5.91%
DED Chief of Staff	100,006.40	117,728.00	17.72%	2.95%
DNR Deputy Director	102,814.40	123,011.20	19.64%	3.27%
Average of all Executive Branch Employees^	43,476.00	53,619.00	23.33%	3.89%

^ - Per the Department of Administrative Services summary of executive branch salaries in Iowa.

# - **Appendix D** includes the full names and abbreviations of the entities.

When comparing the changes in salaries at the Iowa Lottery to changes in salaries of employees of other State entities, Iowa Lottery salaries have outpaced other salaries. For example, the IFA Executive Director's base salary increased at a significantly lower rate than the prior Iowa Lottery CEO's base salary.

**Table 16** compares the number of employees each State entity leader is responsible for based on a summary developed by the Department of Administrative Services for fiscal year 2009 for selected State entity Department Heads and Directors listed in **Tables 14** and **15**. The summary includes 2009 salaries. Another Authority within the State, IFA, and the salary of another State entity with the function of generating revenues, ABD, are included.

<b>Entity*</b>	<b>Position</b>	<b>Salary</b>	<b>Employees</b>
Iowa Lottery	CEO	\$ 167,893.96	109
ABD	Administrator	124,992.40	59
DOC	Director	142,105.34	3,119
DED	Executive Director	145,810.86	146
IFA	Executive Director	128,886.94	82
IPTV	Administrator	129,213.50	110
DHS	Director	152,006.40	5,767
DPH	Director	127,986.82	445
Revenue	Director	148,525.78	376
DOT	Director	147,908.80	3,032

\* - **Appendix D** includes the full names and abbreviations of the entities.

Although Iowa Lottery officials discussed specific reasons why salaries are higher at the Iowa Lottery, comparison of those salaries to other executive level state official's salaries, including that of another Authority, indicate there is an imbalance. As demonstrated by the **Table**, the current Iowa Lottery CEO received a significantly higher salary than the Directors at DHS, DOC and DOT, despite those state agencies having an average of more than 36 times the number of employees the Iowa Lottery CEO is responsible for overseeing. Later in this report, the specific reasons Iowa Lottery officials gave to justify the higher salary are discussed.

**Table 17** compares the fiscal year 2010 Iowa Lottery key personnel job classification salary maximums to the salary maximums of the job classifications of the State positions which were used to pay Iowa Lottery key personnel prior to the Iowa Lottery becoming an Authority. The CEO salary is set by the Governor. Therefore, a job classification salary range does not exist.

<b>Iowa Lottery Job Title</b>	<b>Maximum Salary</b>	<b>State Classification</b>	<b>Maximum State Salary</b>	<b>Difference</b>	<b>Percent Above State Maximum</b>
VP, Chief Operating Officer	\$ 143,686.40	Public Service Executive 5	\$ 117,728.00	25,958.40	22.05%
VP, External Relations	117,665.60	Executive Officer 3	89,710.40	27,955.20	31.16%
VP, Finance	129,916.80	Public Service Executive 4	102,294.40	27,622.40	27.04%
VP, Marketing	117,665.60	Pay Grade 39*	107,265.60	10,400.00	9.70%
VP, Sales	117,665.60	Public Service Executive 4	102,294.40	15,371.20	15.03%
VP, Security	117,665.60	Public Service Executive 4	102,294.40	15,371.20	15.03%
Asst VP, Legal Affairs^	86,652.80	Executive Officer 2	77,896.00	8,756.80	11.24%

\* - Prior to becoming an Authority, the Marketing VP was classified as the Lottery Marketing Director, which was compensated at pay grade 39. The prior job classification no longer exists, so we included the previously used pay grade for comparative purposes. Since it was already a pre-established Lottery-specific position, the change in the maximum is lower than the others.

^ - This position was changed to VP, General Counsel on September 2, 2010 and the maximum salary was increased to \$117,665.60, an increase of 51.10%.

As previously stated, Iowa Lottery officials stated compensation of Iowa Lottery officials could not be compared to other state agencies because the Iowa Lottery functions as an entrepreneurial revenue-generating entity and its operations were not comparable. However, Iowa Lottery officials could not substantiate their position. Defining an entity as “entrepreneurial” does not eliminate its similarities in regard to function. All state lotteries, whether operating as Authorities or state agencies, have the same function and their operations are comparable despite oversight variances. Further, the Iowa Lottery is not the only state entity which generates revenue. For example, ABD also generates revenues for the State, yet it operates successfully as a State agency. In addition, Iowa Lottery officials did not provide examples of inherent operating problems prior to the Iowa Lottery becoming an Authority, other than being unable to obtain legislative authorization to purchase administrative offices prior to becoming an Authority.

As previously stated, Iowa Lottery key personnel salaries are proposed by the CEO and approved by the Iowa Lottery Board. Iowa Lottery officials stated salaries at the Iowa Lottery are structured to ensure they are competitive with the private sector and with other state lotteries. According to Iowa Lottery officials, some state lotteries have lost key personnel to neighboring state lotteries and competitive salaries help ensure key personnel stay with the Iowa Lottery. However, Iowa Lottery officials we spoke with provided no information to indicate this has been an issue in Iowa.

In addition, Iowa Lottery officials stated key personnel at the Iowa Lottery have less job security than other state employees. For example, the Iowa Lottery CEO stated the average lifespan of a CEO with a state lottery is 18 months. Therefore, Iowa Lottery officials stated the Iowa Lottery needs to provide adequate incentive for key officials to take on the risk associated with the less secure positions. We determined this justification was not supported. In the 6 years since the Iowa Lottery became an Authority in fiscal year 2004, only 7 key personnel have left. Of the 7 employees who left, 4 retired. The prior CEO of the Iowa Lottery helped form the Iowa Lottery in 1985 and retired in fiscal year 2008. The current CEO has been the CEO since 2009. Because the Iowa Lottery does not rely on pre-established appropriations to fund its operations and employee salaries, the Iowa Lottery is not as likely to force layoffs due to financial limitations as state agencies.

The main reason the Iowa Lottery developed key personnel positions unique to the Iowa Lottery, according to officials we spoke with, was to develop accurate job descriptions which are consistent with the functions of lottery operations and unique in comparison to typical government job descriptions. This justification is also not adequately supported. Under the State’s pay structure, for example, there is a general description of a Public Service Executive 4. However, each agency with personnel in a Public Service Executive 4 position has its own job description for the personnel functioning at that pay classification within the specific agency. If Iowa Lottery personnel had responsibilities which warranted higher pay classifications, it would have been possible to submit the job responsibilities to DAS to increase the pay grade of each position under the State’s pay plan. The Iowa Lottery is not the only entity utilizing personnel with unique skill sets or duties, yet other entities are required to follow the State’s pay structure.

Many state agencies could use this justification to develop specialized pay plans. For instance, the Department of Natural Resources has Park Rangers, which are unique in comparison to other state agencies. Iowa Public Television utilizes the skills of producers and directors. These personnel positions are also not utilized by other state agencies. However, they have been included in the State’s pay plan.

As stated earlier, reducing monies available to the General Fund by providing additional compensation to its key personnel is not an appropriate use of the Iowa Lottery’s Authority status. In addition, the Iowa Lottery has established key personnel pay plans that allow its key personnel to reach pay plan maximums quicker than other state employees. For example, as previously addressed, after the Iowa Lottery created the new key personnel positions in fiscal year 2005, the Iowa Lottery Board approved increasing key personnel salaries to the maximum amount over a 2-year period. By fiscal year 2006, Iowa Lottery key personnel were paid at the maximum of the newly established pay plans.

**Schedule 1** summarizes the annualized salaries of each key personnel at the Iowa Lottery from fiscal year 2003 through fiscal year 2010. In fiscal year 2010, Iowa Lottery salaries were reduced due to a statewide mandatory pay freeze. Therefore, in order to maintain consistent comparisons, we based fiscal year 2010 annualized salaries on salaries prior to furlough reductions. The **Schedule** calculates the gap between the annualized salary amounts each key personnel received and the maximum salary amount they would have been eligible to receive if the Iowa Lottery had remained a state agency. As demonstrated by the **Schedule**, the Iowa Lottery CEO's annualized salary totaled \$358,856.43 more than the maximum salary allowable for the position under the State's pay plan. In addition, the annualized salaries of the remaining key personnel at the Iowa Lottery were \$589,429.23 more than the maximum salaries they would have been eligible to receive under the State's pay plan.

In addition to the increased salaries, the State incurred additional costs for payroll contributions associated with the increased salaries. **Table 18** summarizes the additional payroll contributions attributable to the Iowa Lottery's increased annualized salaries after becoming an Authority. Totals are based on annualized salaries with adjustments for IPERS and FICA contribution caps from fiscal year 2005 through fiscal year 2010. Prior to fiscal year 2005, the Iowa Lottery's CEO and key personnel salaries were within the parameters of the State's pay plan.

<b>Table 18</b>	
<b>Description</b>	<b>Amount</b>
<u>CEO</u>	
IPERS	\$ 21,386.00
Medicare	5,203.42
FICA^	-
Subtotal CEO	\$ 26,589.42
 <u>Key Personnel*</u>	
IPERS	37,205.44
Medicare	8,546.72
FICA	14,833.74
Subtotal Key Personnel	60,585.90
Total in excess of State's pay plan	<u>\$ 87,175.32</u>

^ - No additional FICA contributions because State's pay plan was already in excess of the FICA contribution cap.

\* - Key personnel totals do not include the Public Affairs Manager since the position did not exist when the Iowa Lottery was a state agency in 2003.

Since implementing higher salaries beginning in fiscal year 2005 as a result of the salary review, authorized compensation of the Iowa Lottery CEO and other key personnel, along with additional payroll contributions on the compensation, total more than \$1 million in excess of the maximum amounts which would have been paid under the State's pay plan.

#### Summary –

Based on the salary data and details of the compensation review reviewed and included in this report, we did not identify adequate support to justify the increases in Iowa Lottery salaries since the Iowa Lottery became an Authority. Factors used to arrive at this conclusion include:

- Iowa Lottery key personnel salaries increased at a higher rate than other state employees when the Iowa Lottery became an Authority, even though the responsibilities of the key personnel did not significantly change and their responsibilities are not greater than the responsibilities of key personnel in other areas of state government. Other State entities did not award similar pay increases.

- Although the Iowa Lottery officials we spoke with stated competitive salaries are necessary to avoid losing key personnel to competition and the CEO position requires additional incentives for CEO's to risk possible removal, the officials did not provide evidence salaries prior to becoming an Authority caused attrition in key personnel positions. The Iowa Lottery provided only 3 examples from 1988 to 1999 in which key personnel left the Iowa Lottery for another position in the lottery industry. Of the 5 key personnel who left the Iowa Lottery since fiscal year 2004, only 1 left the Iowa Lottery for a reason other than retirement. The prior Iowa Lottery CEO was with the Lottery from the time it began in 1985 until the CEO retired in fiscal year 2008.

Attrition has not been an issue at the Iowa Lottery. In addition, there is no apparent reason for certain Iowa Lottery salaries to significantly exceed the salaries established by the State salary structure. The Iowa Lottery does not provide more critical services to the State than other State entities. In addition, other State entities have valuable employees and could reduce the likelihood of attrition by creating higher pay plans for certain employees. However, because state agencies operate in accordance with rules and regulations established to require approval of any pay plan adjustments for key positions and because State entities cannot set their operating budgets, their valued employees are not compensated as well as Iowa Lottery employees. The Iowa Lottery has used its authority to pay higher salaries and corresponding benefits to its employees and thereby reduce monies available to the General Fund of the State.

- As previously addressed, Iowa Lottery officials stated their salaries could not be compared to state agency employee salaries since the Iowa Lottery operates as an entrepreneurial entity. However, the officials we spoke with could not substantiate this position. The function of the Iowa Lottery is still governmental in nature as the Iowa Lottery's function is to generate revenues for the benefit of the State. Iowa Lottery key personnel do not have more critical duties than key personnel at other State entities and higher salaries are not justifiable simply because the Iowa Lottery's role is to generate funds as opposed to providing services vital to the operation of the State.
- Since becoming an Authority in fiscal year 2004, the authorized salaries and related benefits for the Iowa Lottery CEO and other key personnel represent over \$1 million more than the maximum amount permissible under the State's pay plan. As previously stated, we identified certain key personnel positions which were created for specific employees rather than to perform specific key functions.

### **Other Iowa Lottery Employees**

Iowa Lottery employees in positions other than key personnel positions remained in the State's compensation structure within the parameters utilized by other state agencies. For example, Information Technology Specialists at the Iowa Lottery are compensated within the same pay range as Information Technology Specialists at other state agencies.

If a majority of the Iowa Lottery's personnel could be adequately compensated utilizing the State's pay plan, the Iowa Lottery's position regarding the necessity of a separate compensation structure is contradicted. For example:

- Iowa Lottery officials stated the revenue-generating structure of the Iowa Lottery makes the Iowa Lottery different than state agencies and changes the compensation requirements of its staff. However, a majority of Iowa Lottery employees have continued to be compensated through the State's pay plan. If the Iowa Lottery's organizational structure did not impact the salary requirements for a majority of its staff, it shouldn't have been adequate justification to increase the salaries of the key personnel.



- Iowa Lottery officials stated unique job classifications were necessary for the Iowa Lottery because it has unique functions which are not performed by other state entities. However, a majority of Iowa Lottery personnel are able to be compensated for positions unique to the Iowa Lottery through the State's pay plan. For example, Lottery Regional Sales Managers and Lottery District Sales Representatives are included in the State's pay plan. In addition, the Iowa Lottery is not the only State entity with unique job classifications. Almost all State entities have unique job classifications not needed by other state entities. The State's pay plan accommodates these unique job classifications.
- Iowa Lottery officials stated salary increases were necessary to retain key personnel and avoid other state lotteries recruiting its staff. If unique key personnel positions are necessary to avoid attrition of key personnel, it is unclear why the Iowa Lottery has not developed unique salary structures for all of its staff members to ensure retention of all staff and not just key personnel. In addition, other State entities would also benefit from the ability to offer higher salaries to retain employees, but they are restricted based on the parameters of the State's pay plan. The Iowa Lottery's function is not more essential than that of other State entities and it should not have more liberties related to employee compensation.

### **State Lottery Comparative Analysis**

To determine whether the Iowa Lottery is operating as efficiently and effectively as other comparable state lotteries, we conducted comparative analyses between the Iowa Lottery and similar state lotteries. To select comparative state lotteries, we gave consideration to the State's population and whether the State lottery operated in a manner similar to the Iowa Lottery.

Although every state lottery operates differently and many vary according to the types of games offered to customers, the legal age of gambling and whether the state lottery operates as an Authority, we compiled data on a selection of state lotteries and compared it to the Iowa Lottery. Since the population of the states has considerable impact on the potential revenues of each state lottery, we calculated the revenues and expenses on a per capita basis.

**Table 19** contains the data analyzed for the state lotteries included in the comparative analysis for fiscal year 2008 based on per capita averages.

**Table 19**

State	Per Capita Sales	Per Capita Expenses				Per Capita Transfers to State	Percent to State*
		Prize	Retailer	Operations	Percent Expense*		
Connecticut	\$ 285.95	173.71	15.98	14.46	71%	\$ 80.83	28%
Iowa	83.00	48.18	5.21	10.55	77%	18.83	23%
Kansas	84.46	47.45	4.91	8.73	72%	25.00	30%
Kentucky	182.28	115.49	11.74	10.89	76%	44.99	25%
Louisiana	84.72	43.71	4.74	7.08	66%	29.90	35%
New Mexico	75.86	40.36	4.88	8.68	71%	20.57	27%
Oklahoma	58.83	30.98	3.69	4.35	66%	19.66	33%
S. Carolina	221.55	138.50	15.72	9.43	74%	59.22	27%

\* - Sum of percentages does not equal 100% due to changes in non-operating revenues and changes to net assets.

**Prize Expense** - Prize expense is the amount state lotteries return to lottery winners in the form of prizes. Iowa Lottery officials we spoke with stated this amount is important because the goal is to maximize profitability through increased sales. Lottery customers will not be as interested in purchasing lottery tickets if the prize payouts are not attractive.

Retailer Expense - Retailer expense is the amount state lotteries pay retailers for commissions and incentives associated with selling lottery gaming products to customers.

Operations Expense - Operations expense includes lottery system vendor fees, ticketing systems, courier services and administrative expenses. Administrative expenses are largely for advertising and salaries, benefits and associated taxes.

Percent Expense – This indicates how much of the sales per capita went to expenses associated with generating lottery revenues.

Transfers to State – This represents the per capita amount the state lotteries transferred to their state to supplement state budgets.

Percent to State - This indicates how much of the sales per capita went to the state to supplement the state's budget.

As shown in **Table 19**, sales per capita for the state lotteries selected ranged from \$58.83 to \$285.95. The Iowa Lottery was the 6<sup>th</sup> of 8 state lotteries in regard to sales per capita with \$83.00 per capita. The Iowa Lottery's expenses as a percentage of sales were the highest and its transfers to the State General Fund were the lowest as a percentage of sales and in actual dollars per capita.

The Oklahoma and New Mexico lotteries had lower sales than the Iowa Lottery, both in total and per capita. However, both transferred more to their states than the Iowa Lottery, both in total and per capita. The Kansas and Louisiana lotteries brought in approximately \$1.50 more in sales per capita than the Iowa Lottery. However, the Kansas lottery transferred over \$6.00 more per capita to the state and the Louisiana lottery transferred over \$11.00 more per capita to the state than the Iowa Lottery. These differences are a result of operational cost differences. The Iowa Lottery's operational costs are discussed later in this report.

When reviewing total expenses, we compared Iowa Lottery expenses to other state lotteries to determine why the Iowa Lottery's expenses were among the highest reviewed when its sales per capita were among the lowest reviewed. As shown in **Table 19**, the Iowa Lottery contributed more toward prize and retailer expenses than 4 other states in the **Table**, even though 2 of those states had higher per capita sales. In addition, the Iowa Lottery had higher operations costs on a per capita basis than 5 of the other states, even though 3 of those states had higher per capita sales. As a result, the Iowa Lottery's total costs and corresponding transfers to the State were the highest and lowest, respectively, in the selection of state lotteries summarized in **Table 19**.

The Arkansas Democrat Gazette compiled salary data for 44 state lotteries summarizing Lottery Director (i.e. CEO) salaries in 2009. The current Iowa Lottery CEO's salary for 2009 was 9<sup>th</sup> highest of 44 state lotteries recorded. Had the prior Iowa Lottery CEO's salary of \$239,777.46 in fiscal year 2008 been included in the comparison, the prior Iowa Lottery CEO's salary would have been the 5<sup>th</sup> highest of 44. **Table 20** summarizes the salaries of the CEO's recorded by the Arkansas Democrat Gazette for the states previously compared in **Table 19**.

**Table 20**

State	Population (in millions)	Director's Salary
Connecticut	3.5	\$ 164,300.00
Iowa	3.0	170,000.00*
Kansas	2.8	133,250.00
Kentucky	4.3	220,200.00
Louisiana	4.4	192,000.00
New Mexico	2.0	165,000.00
Oklahoma	3.6	184,485.00
South Carolina	4.5	226,829.00

\* - The slight difference between the Iowa Lottery CEO's annualized salary in fiscal year 2009 of \$167,893.96 and \$170,000.00 included in the article does not impact the Iowa Lottery's position in this comparison. In fiscal year 2008, the Iowa Lottery CEO's salary was \$239,777.46.

According to the summary of salaries compiled by the Arkansas Democrat Gazette, the current Iowa Lottery CEO's salary was 5<sup>th</sup> highest of the 8 included in the comparison. The population of Iowa was the 6<sup>th</sup> highest of the 8 states included in the comparison. However, as summarized in **Table 18**, the Iowa Lottery transferred the fewest funds to the State, both on a per capita basis and as a percentage of total sales. Connecticut's population is 3.5 million, but the Director's salary is lower than the salary of the current Iowa Lottery's CEO and Connecticut's lottery transferred over 4 times more per capita to the State than the Iowa Lottery.

We also reviewed U.S. Census information gathered for fiscal year 2007. In a 1996 presentation to the Legislative Fiscal Committee, the prior Iowa Lottery CEO stated comparison of state lotteries using U.S. Census information is inappropriate due to the lack of consideration of differences in geography, demographics, culture, population, definitions and state laws. While such differences could exist, we disagree such comparisons are not useful. The Iowa Lottery is not the only lottery with unique challenges. Therefore, we have compiled U.S. Census data relevant to state lottery operations. **Table 21** summarizes certain U.S. Census data for fiscal year 2007.

**Table 21**

Category	Iowa Rank	Iowa Average	U.S. Average	Difference
Median Family Income	26 of 51	\$ 59,587.00	61,173.00	(1,586.00)
Disposable Income per Capita	32 of 51	\$ 31,020.00	33,619.00	(2,599.00)
Population below Poverty Level	36 of 51	11.0%	13.0%	(2.0%)
Lottery Sales Per Capita	36 of 43	\$ 83.00	200.00	(117.00)
Lottery Administrative Costs as a Percent of Ticket Sales	3 of 42	13.2%	3.0%	10.2%

Based on the U.S. Census data and information summarized in the **Table**, the following is noted:

- Iowa Lottery sales per capita are 58.5% lower than the national average. This amount is not consistent with other statistics collected. For example, Iowa's income per family is within 3% of the national average and Iowa's poverty level is below the national average, which would indicate sales per capita should be closer to the national average. Further, even though disposable income in Iowa is lower than the national average, it is only 8% lower versus per capita sales which are 58.5% lower. Other factors affecting these amounts which the Iowa Lottery brought to our attention are discussed later in this report.

- Iowa Lottery administrative costs as a percent of ticket sales are among the highest in the nation. Certain fixed costs may be consistent across the board, thus increasing the per capita costs for states with lower sales. However, several states with lower sales per capita than the Iowa Lottery also had lower administrative costs as a percent of ticket sales.

Lotteries which had lower sales per capita and lower administrative costs included:

- Washington – Sales were \$80.00 per capita and administrative costs as a percent of ticket sales were 9.0%.
- Arizona – Sales were \$74.00 per capita and administrative costs as a percent of ticket sales were 7.9%.
- Nebraska – Sales were \$69.00 per capita and administrative costs as a percent of ticket sales were 12.4%.
- Oklahoma – Sales were \$56.00 per capita and administrative costs as a percent of ticket sales were 7.7%.

All of the lotteries listed above are state agencies, not Authorities. Additional comparisons between Iowa and specific state lotteries which have operations similar to Iowa were discussed previously.

On September 18, 1996, the prior Iowa Lottery CEO, Edward Stanek, presented a paper to the Legislative Fiscal Committee regarding specific factors affecting comparisons between state lotteries. According to the prior CEO, many factors impact lotteries in a way to make lotteries impossible to compare. While we recognize different environments, rules and regulations definitely exist, we disagree comparisons are not useful.

**Table 22** summarizes the prior CEO's list of potential factors and our assessment of the impact each factor has on the Iowa Lottery. We determined many of the factors listed could impact performance, but to varying degrees depending on each state lottery's specific conditions. Other factors listed appeared to have little relevance or potential impact in regard to current market conditions. For example, Iowa Lottery officials discussed previous requirements to utilize expensive high efficiency vehicles which are no longer applicable today. A selection of factors which are currently most relevant are discussed in the paragraphs following the **Table**.

**Table 22**

<b>Factors Affecting Lottery Performance</b>	<b>Unique to Iowa</b>	<b>Note</b>
Personnel and compensation statutes	No	*
Vehicles and fuel	No	^
Office space costs	No	^
Gaming technology costs	No	*
Economies of scale with ticket costs	No	*
Distribution costs	No	^
Telephone costs	No	^
Urban versus rural costs	No	^
Types of games offered	No	*
History and culture	No	^
Availability of other gambling options	No	*
Population	No	^
Legal age	Yes	~
Advertising costs	No	^
Lottery autonomy	No	*
Legal expenses	No	*

\* - This could impact Iowa Lottery performance, but to varying degrees.

^ - This does not appear to be a significant factor impacting Iowa Lottery performance.

~ - This factor affects Iowa Lottery performance.

As previously stated, the factors listed in the **Table** were initially addressed 15 years ago by the prior Iowa Lottery CEO. Some of these factors have most likely changed over the last 15 years. However, Iowa Lottery officials provided copies of the former Iowa Lottery CEO's paper on comparison issues to demonstrate issues Iowa Lottery representatives believe are still relevant. We reviewed the prior Iowa Lottery CEO's paper and, as summarized in the **Table**, developed conclusions on the potential relevance of each factor. Details regarding certain factors included in the paper and our conclusions regarding those factors are as follows:

Personnel and compensation statutes – Some lotteries are able to set their own compensation structures for employees while others may be subject to salary requirements mandated by a centralized state personnel authority.

While this is correct, the impact of such differences is unknown and varies according to each state. For the Iowa Lottery, salaries are not mandated by a centralized state personnel authority. The Governor approves the CEO's salary and the Iowa Lottery Board approves other key personnel salaries. Therefore, the Iowa Lottery has the ability to adjust salaries to increase or decrease the administrative costs of the State.

Economies of scale with ticket costs – State lotteries with higher populations benefit from economies of scale in regard to purchasing scratch tickets and negotiating more economical online service contracts.

This is true with any procurement in any industry. If the entity is buying more, it has higher negotiating power. Therefore, state lotteries which operate with considerably more volume due to population differences may not be the best ones to compare to the Iowa Lottery. As demonstrated in this report, we selected state lotteries closely matched to Iowa in regard to population to include in our analysis.

Distribution costs – Population density impacts lottery efficiencies. States with larger portions of their populations in metropolitan areas have lower expenses per capita than states in which the population is more evenly distributed throughout the state. According to Iowa Lottery officials we spoke with, distribution costs in Iowa’s rural areas significantly impact its operating costs. The officials stated the distribution costs are more expensive in geographically larger states with higher numbers of rural communities. For instance, New Jersey distribution costs would be less than Iowa.

We concluded most states have rural and metropolitan areas. Therefore, these factors most likely impact state lotteries in a similar manner. However, when we selected the states to compare to the Iowa Lottery (see **Table 18**), we selected those with similar populations to Iowa.

Urban versus rural costs – According to the prior Iowa Lottery CEO, urban lottery customers tend to have higher per capita incomes and spend more money on recreation than do rural customers. Therefore, states with more urban customers may be in an environment more conducive to lottery sales than other states.

While this might impact state lotteries, each state has urban and rural customers to some degree. Therefore, quantifying the impact of serving rural versus urban customers would be difficult.

Types of games offered – Some games require significantly more overhead than others. For example, certain games require significant paybacks in order to maintain success. Although the games are profitable, the associated costs are significant. In addition, certain games are legal in some jurisdictions and not authorized by law in others. For example, video lottery games are very lucrative, yet they are not authorized for all state lotteries.

It is true variances may exist when comparing lotteries on net profits on a game by game basis. In addition, the Iowa Lottery is among state lotteries which are not authorized to offer video lottery games to its customers, although it was authorized to do so from fiscal year 2005 though fiscal year 2006. Laws which preclude state lotteries from offering certain gaming options could negatively impact a state lottery’s efficiency and effectiveness in comparison to other state lotteries.

In fiscal year 2006, the Iowa Lottery recorded record profits related to video lottery games. However, on March 20, 2006, the Legislature banned the use of video lottery games in Iowa. The Iowa Lottery no longer collects revenues for this gaming option. According to casino statistics, only 5 states currently run video lottery terminals.

Availability of other gambling options – In states where other gaming options, such as casinos and racetracks, are competing for discretionary income, potential lottery revenues may be diverted to other gaming options.

We collected data on revenues for states with and without other gaming options, such as casinos and racinos. However, the varying number of casinos and racinos, as well as other outside factors, resulted in inconclusive results in regard to the potential impact of the existence of other gaming options in the state. According to casino information collected from the World Casino website, Iowa has 14 casinos, 3 racinos and 1 tribal casino. The 14 casinos generated revenues of \$1.381 billion and the 3 racinos generated revenues of \$435.62 million in fiscal year 2009. Based on information from Iowa Lottery officials, lottery sales were significantly affected the year casinos began operations in Iowa. However, lottery sales recovered prior to the beginning of the period of our review. In addition, a number of other state lotteries compete with local casinos.

Population – According to the prior Iowa Lottery CEO, U.S. Census population numbers may not be demonstrative of actual lottery sales opportunities. For example, in Washington DC, the daytime population and nighttime population are very different. In addition, in Florida, the full time population is much different than the actual population during certain seasons.

Although Washington DC and Florida are most likely affected more than many lotteries, the fluctuation of population is true for any state. This does not appear to be a factor which would materially affect lottery revenues in most states.

Legal age – In 1994, the Iowa Legislature changed the legal gambling age to 21 years old. Therefore, 18, 19 and 20 year olds in Iowa became ineligible to participate in lottery games, consistent with most other states. According to the prior Iowa Lottery CEO, this resulted in net profits declining 5% while costs remained constant.

We believe the legal age of gambling is a legitimate factor impacting the Iowa Lottery's ability to generate revenues. However, we were unable to quantify the potential impact of the current legal age limitation.

## **Conclusions and Recommendations**

Based on our review of the Iowa Lottery before and after it became an Authority, we determined the Iowa Lottery's status as an Authority is not the reason the Iowa Lottery has recognized revenue increases. The support provided by Iowa Lottery officials was not sufficient to conclude the Iowa Lottery has benefited from becoming an Authority in terms of revenues and transfers to the State. However, it is evident Iowa Lottery key personnel have significantly benefited from the Iowa Lottery becoming an Authority.

Shortly after becoming an Authority, the Iowa Lottery hired a consultant to conduct a compensation review to evaluate key personnel salaries. The prior Iowa Lottery CEO directed the consultant to limit the comparable state lotteries to a pre-selected group of state lotteries which, incidentally, paid higher salaries to their Directors/CEOs than a majority of other state lotteries based on an article published on lottery CEO's and Directors in 2009. Despite the lack of comparability of operating revenues and transfers to the state, the Iowa Lottery based its salaries, in part, on much larger state lotteries with higher per capita transfers to state. In addition, the recommended salary ranges were primarily based on salaries of undisclosed private sector and nonprofit companies, which we were unable to evaluate for comparability.

The compensation review clearly stated the recommendation was to establish salary ranges to allow for gradual growth in salaries in subsequent periods. However, the Iowa Lottery increased most key personnel salaries to the maximum amount within a 2-year period.

When the Iowa Lottery became an Authority, it was to be administered by the Iowa Lottery Board, which consists of 5 Governor-appointed members. **Appendix C** lists the Iowa Lottery Board members from fiscal year 2003 through fiscal year 2010. In accordance with the *Code*, one of the Iowa Lottery Board's responsibilities is to ensure efficient and effective operation of the Iowa Lottery in a manner of integrity. The prior Iowa Lottery CEO and other key personnel had a vested interest in the subject of employee compensation. Therefore, the Iowa Lottery Board should have conducted the compensation review independent of Iowa Lottery employees who would be financially impacted by the results of the review. The prior Iowa Lottery CEO set the parameters of the compensation review and then sent a memorandum to the Iowa Lottery Board members with his recommendations as a result of the compensation review. Although it appears the Iowa Lottery Board members had access to the compensation review, they did not seek explanations from the consultant and approved all the recommendations of the prior Iowa Lottery CEO. Had they exercised their fiduciary responsibility as the administrators of the Iowa Lottery and conducted independent salary reviews, we do not believe the aggressive salary increases would have occurred.

As a result of the Iowa Lottery Board's approval of the Iowa Lottery CEO's recommendations, key personnel at the Iowa Lottery received significant salary increases and currently receive higher salaries than personnel in comparable positions within the State. In addition, when comparing the Iowa Lottery to other state lotteries in terms of CEO compensation, state population and amounts transferred to the state, the current Iowa Lottery CEO receives, as did the prior Iowa

Lottery CEO, a higher salary for lower per capita transfers to the state. The Iowa Lottery has significantly higher operating costs than most other state lotteries as a percentage of sales, yet the current (and prior) Iowa Lottery CEO ranks among the highest paid lottery CEO's in the country.

The Iowa Lottery did not materially change its business practices when it became an Authority, and becoming an Authority should not have been a reason for increasing salaries. Authorities within the State still operate for the benefit of the State and Authority employees should continue to be compensated in a manner consistent with other State employees through the State's pay plan. By approving significant salary increases for key personnel, the Iowa Lottery effectively declared its personnel are more valuable to the State than personnel remaining under the State's pay plan.

### **Recommendations**

- The Legislature should establish controls over compensation practices of all State Authorities, including the Iowa Lottery, to ensure Authority status does not result in salaries which are not based on employee responsibilities, experience and other valid documented considerations. In addition, the Legislature, which authorized key personnel positions in the Authority's enabling legislation, should determine if it is necessary to maintain key positions.
- The Legislature should conduct a comparison of all State Authority personnel salaries with State agency personnel salaries to identify any other salary anomalies.
- The Iowa Lottery Board should work with the Department of Administrative Services to conduct an independent compensation review, including State personnel operating in similar positions as well as state lotteries with comparable state populations, demographics and revenues. The independent compensation review should also include consideration of cost of living and employee benefits.
- The Iowa Lottery CEO and Board should review current key personnel salaries at the Iowa Lottery to determine whether they are appropriate after the Board's independent compensation review is completed.

**Response** – The Iowa Lottery's response is included in **Appendix E**.



## **Schedule**

A Review of the Iowa Lottery Authority  
Annual Base Salaries in Excess of State Pay Plan  
July 1, 2002 through June 30, 2010

Description*	FY2003	FY2004	FY2005	FY2006	FY2007
<b><u>Annualized Lottery Salaries - Approved by Governor</u></b>					
<u>State Pay Plan for Lottery Commissioner - Pay Plan 24, Pay Grade 9 until FY06 - then to Pay Plan 24, Pay Grade 7</u>					
Maximum bi-weekly base salary	\$ 4,852.88	4,852.88	4,852.88	5,483.77	5,593.46
Maximum annual base salary	126,175.00	126,175.00	126,175.00	142,578.00	145,430.00
<u>Approved Lottery Salaries</u>					
Chief Executive Officer:					
Edward Stanek					
Bi-weekly base salary	4,723.51	4,839.86	7,961.60	8,298.44	8,884.23
Annualized base salary	122,811.38	125,836.38	207,001.60	215,759.36	230,989.85
Annual base salary in excess of State pay plan	-	-	80,826.60	73,181.36	85,559.85
Terry Rich					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual salary in excess of State pay plan	-	-	-	-	-
Subtotal above pre-Authority maximum approved by Governor	-	-	80,826.60	73,181.36	85,559.85
<b><u>Annualized Lottery Salaries - Approved by Iowa Lottery Board</u></b>					
<u>State Pay Plan for Public Service Executive 4 - Pay Grade 38</u>					
Maximum bi-weekly base salary	3,342.40	3,409.60	3,545.60	3,547.20	3,708.80
Maximum annual base salary	86,902.40	88,649.60	92,185.60	92,227.20	96,428.80
<u>Approved Lottery Salaries</u>					
VP Finance:					
Steve King					
Bi-weekly base salary	3,230.74	3,409.60	3,956.80	4,483.72	4,591.85
Annualized base salary	83,999.20	88,649.60	102,876.80	116,576.80	119,388.15
Annual base salary in excess of State pay plan	-	-	10,691.20	24,349.60	22,959.35
Steve King/Brenda Loy					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-
Brenda Loy					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-
Subtotal above pre-Authority maximum	-	-	10,691.20	24,349.60	22,959.35

<b>FY2008</b>	<b>FY2009</b>	<b>FY2010^</b>	<b>Totals</b>
5,761.62	5,934.62	5,934.62	
149,802.00	154,300.00	154,300.00	
9,222.21	-	-	
239,777.46	-	-	
89,975.46	-	-	\$ 329,543.27
-	6,457.46	6,539.20	
-	167,893.96	170,019.20	
-	13,593.96	15,719.20	29,313.16
89,975.46	13,593.96	15,719.20	\$ 358,856.43
3,820.00	3,934.40	3,934.40	
99,320.00	102,294.40	102,294.40	
4,851.20	-	-	
126,131.20	-	-	
26,811.20	-	-	84,811.35
-	4,563.97	-	
-	118,663.22	-	
-	16,368.82	-	16,368.82
-	-	4,131.20	
-	-	107,411.20	
-	-	5,116.80	5,116.80
26,811.20	16,368.82	5,116.80	106,296.97

A Review of the Iowa Lottery Authority  
Annual Base Salaries in Excess of State Pay Plan  
July 1, 2002 through June 30, 2010

Description*	FY2003	FY2004	FY2005	FY2006	FY2007
VP Sales:					
Larry Loss					
Bi-weekly base salary	2,856.86	3,090.46	3,644.00	4,063.23	4,158.58
Annualized base salary	74,278.40	80,352.00	94,744.00	105,644.00	108,123.02
Annual base salary in excess of State pay plan	-	-	2,558.40	13,416.80	11,694.22
Subtotal above pre-Authority maximum	-	-	2,558.40	13,416.80	11,694.22
VP Security:					
Harry Braafhart					
Bi-weekly base salary	3,230.74	3,409.60	3,744.80	4,067.11	4,158.58
Annualized base salary	83,999.20	88,649.60	97,364.80	105,744.80	108,123.02
Annual base salary in excess of State pay plan	-	-	5,179.20	13,517.60	11,694.22
Harry Braafhart/Joeseph Diaz					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-
Joeseph Diaz					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-
Subtotal above pre-Authority maximum	-	-	5,179.20	13,517.60	11,694.22
<b>State Pay Plan for Marketing Director - equivalent to Pay Grade 39</b>					
Maximum bi-weekly base salary	3,505.60	3,576.00	3,719.20	3,720.00	3,888.80
Maximum annual base salary	91,145.60	92,976.00	96,699.20	96,720.00	101,108.80
<b>Approved Lottery Salaries</b>					
VP Marketing:					
Joeseph Hrdlicka					
Bi-weekly base salary	3,223.23	3,477.42	3,669.85	3,832.55	4,071.07
Annualized base salary	83,804.00	90,412.80	95,416.00	99,646.35	105,847.84
Annual base salary in excess of State pay plan	-	-	-	2,926.35	4,739.04

<b>FY2008</b>	<b>FY2009</b>	<b>FY2010^</b>	<b>Totals</b>
4,393.60	4,525.41	4,525.60	
114,233.60	117,660.66	117,665.60	
14,913.60	15,366.26	15,371.20	73,320.48
14,913.60	15,366.26	15,371.20	73,320.48
4,372.00	-	-	
113,672.00	-	-	
14,352.00	-	-	44,743.02
-	4,024.99	-	
-	104,649.74	-	
-	2,355.34	-	2,355.34
-	-	3,865.60	
-	-	100,505.60	
-	-	-	-
14,352.00	2,355.34	-	47,098.36
4,005.60	4,125.60	4,125.60	
104,145.60	107,265.60	107,265.60	
4,286.40	4,525.60		
111,446.40	117,665.60		
7,300.80	10,400.00		25,366.19

A Review of the Iowa Lottery Authority  
Annual Base Salaries in Excess of State Pay Plan  
July 1, 2002 through June 30, 2010

Description*	FY2003	FY2004	FY2005	FY2006	FY2007
Joeseeph Hrdlicka/Teri Tebockhorst					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-
Subtotal above pre-Authority maximum	-	-	-	2,926.35	4,739.04
<u>State Pay Plan for Public Service Executive 5 - Pay Grade 41</u>					
Maximum bi-weekly base salary	3,846.40	3,923.20	4,080.00	4,081.60	4,268.00
Maximum annual base salary	100,006.40	102,003.20	106,080.00	106,121.60	110,968.00
<u>Approved Lottery Salaries</u>					
VP Chief Operating Officer:					
Ken Brickman					
Bi-weekly base salary	3,717.94	3,923.20	4,452.80	4,962.03	5,078.35
Annualized base salary	96,666.40	102,003.20	115,772.80	129,012.80	132,037.09
Annual base salary in excess of State pay plan	-	-	9,692.80	22,891.20	21,069.09
Subtotal above pre-Authority maximum	-	-	9,692.80	22,891.20	21,069.09
<u>State Pay Plan for Executive Officer 3- Pay Grade 35</u>					
Maximum bi-weekly base salary	2,931.20	2,989.60	3,108.80	3,110.40	3,252.00
Maximum annual base salary	76,211.20	77,729.60	80,828.80	80,870.40	84,552.00
<u>Approved Lottery Salaries</u>					
VP External Relations:					
Mary Neubauer					
Bi-weekly base salary	2,770.65	2,972.80	3,330.40	3,658.86	3,905.18
Annualized base salary	72,036.80	77,292.80	86,590.40	95,130.40	101,534.72
Annual base salary in excess of State pay plan	-	-	5,761.60	14,260.00	16,982.72
Subtotal above pre-Authority maximum	-	-	5,761.60	14,260.00	16,982.72
<u>State Pay Plan for Executive Officer 2 (changed to Asst. VP Legal Affairs) - Pay Grade 32</u>					
Maximum bi-weekly base salary	2,545.60	2,596.80	2,700.80	2,701.60	2,824.00
Maximum annual base salary	66,185.60	67,516.80	70,220.80	70,241.60	73,424.00
<u>Approved Lottery Salaries</u>					
Assistant VP Legal Affairs:#					
Brandi Hoffman (King)					
Bi-weekly base salary	1,842.40	1,938.15	2,195.85	-	-
Annualized base salary	47,902.40	50,392.00	57,092.00	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-

<b>FY2008</b>	<b>FY2009</b>	<b>FY2010^</b>	<b>Totals</b>
-	-	4,395.30	
-	-	114,277.70	
-	-	7,012.10	7,012.10
7,300.80	10,400.00	7,012.10	32,378.29
4,396.00	4,528.00	4,528.00	
114,296.00	117,728.00	117,728.00	
5,365.60	5,526.47	5,526.40	
139,505.60	143,688.10	143,686.40	
25,209.60	25,960.10	25,958.40	130,781.19
25,209.60	25,960.10	25,958.40	130,781.19
3,349.60	3,450.40	3,450.40	
87,089.60	89,710.40	89,710.40	
4,393.60	4,525.41	4,525.60	
114,233.60	117,660.66	117,665.60	
27,144.00	27,950.26	27,955.20	120,053.78
27,144.00	27,950.26	27,955.20	120,053.78
2,908.80	2,996.00	2,996.00	
75,628.80	77,896.00	77,896.00	
-	-	-	
-	-	-	
-	-	-	-

A Review of the Iowa Lottery Authority  
Annual Base Salaries in Excess of State Pay Plan  
July 1, 2002 through June 30, 2010

Description*	FY2003	FY2004	FY2005	FY2006	FY2007
Marci Tooman/Brandi Hoffman (King)					
Bi-weekly base salary	-	-	-	2,870.40	-
Annualized base salary	-	-	-	74,630.40	-
Annual base salary in excess of State pay plan	-	-	-	4,388.80	-
Marci Tooman					
Bi-weekly base salary	-	-	-	-	3,020.88
Annualized base salary	-	-	-	-	78,542.88
Annual base salary in excess of State pay plan	-	-	-	-	5,118.88
Marci Tooman/Molly Juffernbruch~					
Bi-weekly base salary	-	-	-	-	-
Annualized base salary	-	-	-	-	-
Annual base salary in excess of State pay plan	-	-	-	-	-
Subtotal above pre-Authority maximum	-	-	-	4,388.80	5,118.88
<b>State Pay Plan for Secretary 3 - Pay Grade 22</b>					
Maximum bi-weekly base salary	1,583.20	1,615.20	1,680.00	1,680.00	1,756.80
Maximum annual base salary	41,163.20	41,995.20	43,680.00	43,680.00	45,676.80
<b>Approved Lottery Salaries</b>					
Executive Secretary:					
Barbara Deheck					
Bi-weekly base salary	1,530.55	1,615.20	1,829.60	2,035.75	2,083.29
Annualized base salary	39,794.40	41,995.20	47,569.60	52,929.60	54,165.51
Annual base salary in excess of State pay plan	-	-	3,889.60	9,249.60	8,488.71
Subtotal above pre-Authority maximum	-	-	3,889.60	9,249.60	8,488.71
Subtotal Key Employees (less CEO) above pre-Authority maximum approved by Iowa Lottery Board and CEO	-	-	37,772.80	104,999.95	102,746.23

Total annualized salaries and payroll contributions in excess of maximums allowed under pre-Authority pay plans

- \* - State Pay Plan amounts effective for the last pay period of the fiscal year. Annualized base salaries were calculated using actual base salaries applied over 26 pay periods. When changes in key personnel were made, key positions were not immediately filled.
- ^ In FY 2010, the Iowa Lottery was required to implement furloughs. Therefore, actual salaries received were lower. Amounts shown are authorized amounts prior to furloughs annualized over 26 pay periods.
- ~ Juffernbruch was only part time in FY10 through part of FY11. For comparative purposes, we calculated her full time salary and compared it to the State's pay plan.



<b>FY2008</b>	<b>FY2009</b>	<b>FY2010^</b>	<b>Totals</b>
-	-	-	
-	-	-	
-	-	-	4,388.80
3,093.69	3,148.04	-	
80,435.89	81,849.12	-	
4,807.09	3,953.12	-	13,879.09
-	-	3,332.80	
-	-	86,652.80	
-	-	8,756.80	8,756.80
4,807.09	3,953.12	8,756.80	27,024.69
1,809.60	1,864.00	1,864.00	
47,046.60	48,464.00	48,464.00	
2,200.80	2,255.93	2,267.20	
57,220.80	58,654.16	58,947.20	
10,174.20	10,190.16	10,483.20	52,475.47
10,174.20	10,190.16	10,483.20	52,475.47
130,712.49	112,544.06	100,653.70	589,429.23
			\$ 948,285.66

A Review of the Iowa Lottery Authority

Staff

This review was performed by:

Annette K. Campbell, CPA, Director  
James Cunningham, CPA, Manager  
Tina R. Stuart, Senior Auditor II  
Mark Moglestad, Senior Auditor  
Brett M. Zeller, Senior Auditor  
Alison Herold, Senior Auditor  
Tracey Gerrish, Staff Auditor

A handwritten signature in black ink, reading "Tamera S. Kusian". The signature is written in a cursive style with a large, stylized 'T' and 'K'.

Tamera S. Kusian, CPA  
Deputy Auditor of State

## **Appendices**

A Review of the Iowa Lottery Authority

Excerpt from Compensation Review

**V. Recommendations**

Base on the total survey results, the following is being recommended:

- ◆ Increase CEO salary to attain or exceed lottery survey market average
- ◆ Increase surveyed job salary ranges by an average 17%
- ◆ Design ranges to incorporate midpoints
- ◆ Increase range spread to 50%
- ◆ Design ranges so there is an incremental flow and approximated distance (minimum 10%) between midpoints

## A Review of the Iowa Lottery Authority

### Excerpt from Compensation Review

#### *Recommendation Rationale:*

Based on the three sources used for this compensation study, Iowa Lottery executive salaries are significantly below market. Though the majority of the state lotteries are larger in state population, revenues, and profits, providing a potential reason for overall higher salaries than Iowa, the matches from the published surveys specific to company size, industry type, and/or geographic area, corroborate the lottery comparisons showing IA Lottery significantly behind market (*results from published survey sources only, not shown in above charts, show Iowa salaries 44% below overall market average with overall average bonus payout at 24% of base salary*). With that said the Compensation Data survey combines for-profit and not-for-profit organizations while Salary.com exclusively includes not-for-profit organizations resulting in higher salary averages in the Compensation Data survey; so while it is important to recognize Iowa salaries are below market, the data can be slightly discounted for the reasons noted above.

#### CEO Pay

The CEO job is not on a salary range, common for this position level, which is why the recommendation focuses on pay vs. salary range. Based on the current CEO's level of experience alone, it is warranted, and thus recommended, the CEO pay should reflect **no less** than the peer group market rate of \$164,119, while other factors such as performance, need to be taken into consideration when making final pay determination.

The peer group average does not include Tennessee CEO pay of \$350,000 which would adjust the market to \$190,673, an increase exceeding 16%. This amount of increase to an average based on one position is considered a skewing of the data and since a common and acceptable practice is to remove the highest salary from compensation review especially if far removed from the next highest salary, the Tennessee salary is not included in the CEO lottery market average.

#### Salary Ranges

The overall salary ranges are below market while the range design and widths are not aligned with customary practices. Salary ranges per job grade customarily incorporate a **minimum**, **midpoint**, and **maximum** with midpoint considered a market rate, usually determined by a market average of all benchmark job salaries within the specific range. Salary range widths, especially for management level jobs, tend to approximate 50% with minimums at 80% and maximums at 120% of the midpoint; Iowa Lottery salary ranges span an average 39% from minimum to maximum without midpoints.<sup>10</sup>

<sup>10</sup> IA midpoints listed in section III-C were calculated for comparison purposes

**A Review of the Iowa Lottery Authority****Excerpt from Compensation Review**

Salary ranges are designed to not only determine job compensation value but to be used as a compensation guide with midpoints being an essential part of that guide. Midpoints are often considered to be an approximate five year rate; therefore, managers can better gauge seasoned vs. entry level employee salaries. Many additional factors also determine individual salary progression (i.e. performance, promotions, etc.) within a grade range, but the midpoint is an important range component and should be used as a salary guide as well as a market indicator.

Based on the above considerations along with the survey results, the following salary ranges for each surveyed job are being recommended:

<b>Job Title</b>	<b>Current Grade</b>	<b>Min</b>	<b>Mdpt</b>	<b>Max</b>	<b>% Incr</b>
<b>EVP/COO</b>	<b>41</b>	<b>\$86,360</b>	<b>\$107,950</b>	<b>\$129,540</b>	<b>22%</b>
<b>VP, Marketing</b>		<b>\$78,080</b>	<b>\$97,600</b>	<b>\$117,120</b>	<b>21%</b>
<b>VP, Security</b>	<b>38</b>	<b>\$70,720</b>	<b>\$88,400</b>	<b>\$106,080</b>	<b>15%</b>
<b>VP, Finance/CFO</b>	<b>38</b>	<b>\$70,720</b>	<b>\$88,400</b>	<b>\$106,080</b>	<b>15%</b>
<b>VP, Sales</b>	<b>38</b>	<b>\$70,720</b>	<b>\$88,400</b>	<b>\$106,080</b>	<b>15%</b>
<b>VP, Ext Relations</b>	<b>35</b>	<b>\$60,080</b>	<b>\$75,100</b>	<b>\$90,120</b>	<b>15%</b>
<b>Org Dev Mgr</b>	<b>32</b>	<b>\$52,080</b>	<b>\$65,100</b>	<b>\$78,120</b>	<b>15%</b>

Each salary range recommendation is based on two factors: (a) current market and (2) current placement within organization. Internal equity is as important (sometimes more) than external equity, and since this compensation review did not involve reviewing grade levels, all positions are recommended to remain in their same organizational placement except for the Organizational Development Manager (*see Additional Factors*).

The recommended range increase of 17% is significant but does not bring the midpoints to market; however, the 17% is believed to be appropriate since the market is being slightly discounted and the ranges are better aligned with the market after increase. In addition, a common and acceptable practice is to increase salaries/ranges in stages versus a dramatic increase, so if it is determined the ranges should be higher based on market, a second adjustment can be implemented at a designated future date. Also, annual reviews should be regularly conducted to determine range adjustments per year so market alignment is maintained.

## A Review of the Iowa Lottery Authority

### Excerpt from Compensation Review

#### Additional Considerations

- ◆ The cost of increasing the salary ranges will be minimal to Iowa Lottery. Though the range increase is an average 17%, most of the incumbent salaries are at or close to the current range maximum. As a result, the movement of the salary ranges brings the incumbent pay to a more appropriate range position. However, if Iowa Lottery wishes to apply salary adjustments at this time based on the market averages, the ranges are now wide enough to accommodate further salary growth.
  
- ◆ *Organizational Development Manager:*
  - (a) Minimum Adjustment: The only salary that falls below the new minimum is that of the Organizational Development Manager. The cost to adjust the Manager's salary to the new range minimum is \$2,264 over a one year period.
  
  - (b) Grade Repositioning: While the Organizational Development Manager was not matched by any of the other lotteries or included in any of the published surveys, the job of attorney or in-house counsel was matched to this job. Though the job only requires 3 years experience with a J.D., the level of attorney pay which matches these requirements is in the \$70,000 range. As a result, it is recommended to review this job for possible repositioning to a higher grade level within the Iowa Lottery organization.
  
  - (c) Title Change: Organizational Development Manager is a misnomer for this position since the title is usually reserved for Human Resources professionals who specialize in areas such as team building, leadership building, change management, etc. Therefore, it is recommended to re-title Organizational Development Manager to Attorney, In-House Counsel, or Mgr, Legislative Affairs or any other titles that better depict the overall job purpose, intent, and business focus.
  
- ◆ Regarding VP, Sales and VP, Marketing, most of the lotteries have one VP position responsible for both functions with Directors from Sales and Marketing reporting to the VP. As previously discussed, the Iowa Lottery tends to be a flatter organization without much hierarchy. These factors were considered while matching the Sales and Marketing jobs. See further details in Appendix III and IV.

## A Review of the Iowa Lottery Authority

### Excerpt from June 18, 2004 Iowa Lottery Board Meeting Minutes

#### Closed Session

Clausen moved, pursuant to Iowa Code section 21.5(1)(i), that the Board go into closed session to discuss possible appointments of the following employees: Harry Braafhart, Brandi Hoffmann, Steve King, Mary Neubauer, Kenneth Brickman, Joe Hrdlicka, and Larry Loss in order to prevent the possibility of needless and irreparable injury to the individuals' reputations and because they had requested a closed session in writing. The motion was seconded by Baxter and carried by a unanimous roll-call vote.

The employees' request is included in this record as "Attachment B."

The Board convened in closed session at 10:18 a.m. At 10:59 a.m. Clausen moved to return to open session. The motion was seconded by Junge and carried by a unanimous roll-call vote. No action was taken in closed session.

#### Key Employee Designations and Compensation

The chair asked for a motion for approval of the key employee appointments and salary adjustments as proposed in Table 1. (See below.)

Table 1  
Offers for Positions of Key Employees and Compensation  
As Per Chapter 99G

Position	Person	Salary FY 2005	Salary FY 2006*
COO	Ken Brickman	\$115,771.50	129,540
CFO	Steve King	102,884.80	117,120
VP Sales	Larry Loss	94,744.00	106,080
VP Security	Harry Braafhart	97,365.00	106,080
VP External Affairs	Mary Neubauer	86,600.50	95,472
VP Marketing	Joe Hrdlicka	95,523.00	
Assistant VP, Legal	Brandi Hoffmann	57,288.00	

\*Subject to favorable annual performance evaluation.

Clausen moved to authorize the key employee designations reflected in Table 1 and the salary levels therein. The motion was seconded by Junge and carried unanimously.

Adjournment having been moved and carried, the meeting adjourned at 11:05 a.m.



A Review of the Iowa Lottery Authority

Iowa Lottery Board for Fiscal Years 2003 through 2010

**Iowa Lottery Board**

**Fiscal year 2003**

Timothy Clausen, Chairperson  
Elaine Baxter  
Bill Brosnahan  
Mary Junge  
Michael McCoy  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2005**

Mary Junge, Chairperson  
Elaine Baxter  
Bill Brosnahan  
Timothy Clausen  
Michael McCoy  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2007**

Mary Junge, Chairperson  
Elaine Baxter  
Timothy Clausen  
Mike Klappholz  
Tom Rial  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2009**

Mary Junge, Chairperson  
Elaine Baxter  
Mike Klappholz  
Tom Rial  
Brad Schroeder  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2004**

Michael McCoy, Chairperson  
Elaine Baxter  
Bill Brosnahan  
Timothy Clausen  
Mary Junge  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2006**

Elaine Baxter, Chairperson  
Mary Junge  
Mike Klappholz  
Timothy Clausen  
Michael McCoy  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2008**

Mary Junge, Chairperson  
Elaine Baxter  
Mike Klappholz  
Tom Rial  
Brad Schroeder  
Michael Fitzgerald, Ex-Officio Member

**Fiscal year 2010**

Mike Klappholz, Chairperson  
Mary Junge  
Elaine Baxter  
Tom Rial  
Brad Schroeder  
Michael Fitzgerald, Ex-Officio Member

## A Review of the Iowa Lottery Authority

## List of Acronyms

<b><u>Acronym</u></b>	<b><u>Description</u></b>
ABD	Alcoholic Beverages Division of the Department of Commerce
CEO	Chief Executive Officer
DHS	Department of Human Services
DED	Department of Economic Development
DNR	Department of Natural Resources
DOC	Department of Corrections
DOT	Department of Transportation
DPH	Department of Public Health
IFA	Iowa Finance Authority
IPTV	Iowa Public Television
NASPL	North American Association of State and Provincial Lotteries
VP	Vice President

A Review of the Iowa Lottery Authority

Iowa Lottery's Response



2323 Grand Avenue · Des Moines · Iowa 50312-5307  
Telephone: 515-725-7900 · Fax: 515-725-7882  
www.ialottery.com

Terry E. Branstad · Governor

Kim Reynolds · Lt. Governor

Terry Rich · Chief Executive Officer

April 12, 2012

The Honorable David A. Vaudt  
Auditor of State  
State Capitol Building  
Des Moines, IA 50319

Dear David:

Thank you for your report. It is timely in that the Lottery's Board of Directors will be formulating the lottery's 2014 budget in the coming months.

We concluded that the focus of your report is that the pay of the Lottery CEO and key employees is different than the standard state employee pay scale. We agree with that conclusion.

As stated in your report, in 2004, the Lottery Board and Iowa's Governor agreed with a study that compared lottery management salaries with those of management employees at like-managed lotteries, the private sector, and organizations of similar size in the education/government/nonprofit sector. The salary decisions made were front-page news during a thorough public vetting.

The Board continuously evaluates the return on this investment in leadership at our market-driven, entrepreneurial operation and adjusts accordingly. We believe this model has proven successful.

I will recommend that the Board use your report, as it does the input from our numerous other forms of outside oversight, to evaluate ways to maximize the lottery's contribution to state causes.

Please be aware that Lottery Board members have expressed disappointment that neither they nor the past lottery CEO were contacted to provide information for this report, although your office did contact a consultant involved. We encourage you to reach out to these Iowa citizens to learn their perspective.

We're proud of the success the Iowa Lottery Authority has achieved and know it takes good personnel to get there. We continue record sales from our core products (lotto, instant-scratch and pull-tab tickets). The recent handling of the claimed – and then unclaimed – Hot Lotto® ticket also clearly demonstrates the expertise of the professional, knowledgeable management team at the Iowa Lottery.

We appreciate your office's annual financial audits of the lottery along with this latest report and look forward to its prompt release.

Best regards,

A handwritten signature in black ink, appearing to read "Terry Rich".

Terry Rich